# THE ECONOMICS OF BRANCH BANKING

BERNHARD OSTROLENK

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By
BERNHARD OSTROLENK
*Editorial Staff, "The Annalist"*

HARPER & BROTHERS PUBLISHERS
NEW YORK AND LONDON
1930

THE ECONOMICS OF BRANCH BANKING

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*First Edition*
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TO

MAURICE FELS

WHOSE UNOSTENTATIOUS AND EFFECTIVE
LABORS FOR SCHOLARSHIP HAVE MADE
HIM A BENEFACTOR OF LEARNING

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# CONTENTS


| | | |
|---|---|---|
| | Preface | ix |
| I | Economic Roots of a Changing Banking System | 1 |
| II | Metropolitan Bank Mergers | 13 |
| III | The Critical Position of the Country Banks | 27 |
| IV | The Development of Chain Banking | 50 |
| V | The Reasons for Branch Banking | 75 |
| VI | Branch Banking and Stabilized Agriculture | 94 |
| VII | Branch Banking and Stabilized Business | 117 |
| VIII | Branch Banking in the United Kingdom | 132 |
| IX | Branch Banking in Canada | 146 |
| X | Branch Banking in California | 169 |
| XI | The Revolution in Banking Theory | 189 |
| | Index | 203 |

# PREFACE

MY INTEREST in chain banking dates back some fourteen years when, as a teacher in Minnesota, I had opportunity to observe a small chain banking system at its best. It was dominated by the personality of a man who understood the business and agricultural problems of his community as did no other man there, whose banking operations were conducted with unimpeachable probity and who was justly well known for the soundness of his practices. Though operating a chain of banks, he was in every sense a unit banker to the communities. This chain has withstood the withering influences of the war and post-war depression and has represented in a small and unpretentious way all that is admirable in American business and sound in American banking.

That I still retain my admiration for my erstwhile friend and yet feel compelled, as a piece of intellectual honesty, to write a book that will hasten what seems to me the inevitable extinction of this group, confirms Heine's cynical observation on things contradictory, "Wie witzig ist unser Gott." In common with many students of the American banking system, the independent banker, like the independent farmer, occupied in my economic thinking a place somewhat apart from strict economic need. His existence had always justified itself to me on

other than economic grounds. I have changed my point of view reluctantly and regretfully, being now convinced that a pragmatic exposition of realities is no disservice to the country banker. I do not herald his exit jubilantly. The substitution of the branch bank manager for the country banker will probably not usher in a financial millennium. But it is not branch banking that forces the country banker from the financial stage; it is the changing economic condition that confronts the rural financial world and supplies the impetus toward a new system.

I desire to acknowledge my indebtedness to the Honorable J. W. Pole, Comptroller of the Currency, for placing at my disposal a great body of material, to many bankers and bank officials for data and information; and special acknowledgment to Esther W. Ostrolenk for her important share in the preparation of this manuscript.

The chapter on "Branch Banking in Canada" was prepared and written in its entirety by Henry Hansen, Canadian editor of *The Annalist*.

Chapters VI and XI appeared in part as articles in the *Atlantic Monthly* and Chapter II appeared in part in "Editorial Research Reports."

BERNHARD OSTROLENK

The Annalist
December 27, 1929.

*The Economics*
*of Branch Banking*

# *The Economics of Branch Banking*

## CHAPTER I

### Economic Roots of a Changing Banking System

CENTRALIZED production and distribution is ushering American industry into a business era that projects the trust forming period into a second industrial revolution; one that is characterized by the progressive elimination from the economic field of the small independent business man, whether retailer, wholesaler or manufacturer, and the substitution for him of centralized business enterprises reaching their tentacles into every town and city of America and embracing every kind of business activity. Consolidations in steel, oil, automobile, tobacco, meat packing and other industries are obvious examples of the trend during the last half century. But now, new and additional merging forces are under way that threaten more than ever the field in which the independent business man thought himself supreme.

It may be premature to say that the small busi-

ness man is doomed, that his fight for financial independence is hopeless, that he is opposed by economic forces so superior as to make his exit from the business stage inevitable. Such assertions may seem far-fetched in face of the fact that even today there is astounding vitality in the smaller business organizations and that a surprisingly large number of them manage to exist alongside of large, well-financed, centralized corporations. By cooperation, by the development of industrial institutes, by imitation of the more efficient business methods of the corporation, the independent business man is resisting, to some extent successfully, the inroads of corporate business with its superior management, competent supervision, and effective use of adequate capital. Analysis of commercial failures, on the other hand, shows that so far as the small man is concerned, there was no prosperity in the United States in 1928, that the ratio of failures was the highest ever known in the grades of business to which the failed firms belonged.[1] Possibly the future of the small business man is not as hopeless as the trend would indicate, but there is every evidence that business concentration is proceeding with greater momentum than the development of the smaller business enterprises, that in fact the average small enterprise is growing larger, employs more labor and uses greater number of horsepower machinery.

It is difficult to secure exact data to measure definitely these changes. In 1927, the wage earners per establishment, for the industries for which the census

[1] For full discussion and original sources of data given here see *Recent Economic Changes*, Chapter V.

was taken, had increased to an index of 112 compared with 100 in 1914. This does not seem an excessive concentration until we examine horsepower increase from 100 in 1914 to 163 in 1927 and the value of the product per establishment which increased from 100 to 241, thus definitely indicating the larger sized average establishment even if the figures be corrected for the increase in price levels that have taken place. The number of establishments, employing less than 100 wage earners, increased from 87,903 to 92,167, or about 5 per cent, but establishments employing more than 1,000 persons increased from 648 to 963, or about 50 per cent. In spite of the astonishingly large number of small establishments and the fact that establishments with more than 1,000 wage earners were less than 1,000 in 1927, the figures are significant in indicating the trend.

Another indicator of the increasing size of business units is the income tax returns as compiled by the internal revenue bureau. The number of corporations reporting a net income of more than $100,000 was 9,634 in 1918; they fell in response to the severe business depression to 5,330 in 1921 and rose to 10,300 in 1926. The increase was largely in the public utility and finance groups.

A more direct method of ascertaining the merging tendencies is an examination of specific business enterprises. The Committee on Recent Economic Changes collected reports of 16,000 mergers in manufacturing and mining but excluded from their tabulation several other important business groups which clearly indicate the merging tendency. Thus

the vertical integration of the motion picture industry is omitted; though theaters have been grouped in chains, which in turn have come under the control of film distributors and the latter under film producers. The tabulation does not include a large number of mergers in department stores and hotels, nor the extension of corporate control beyond the borders of the United States, nor the attempted and checked (by the Interstate Commerce Commission) mergers in the railroad field, nor the banking mergers to be discussed more fully later. The Committee on Economic Changes calls attention to the difficulty of classifying, verifying and comparing these reported mergers, but discounting probable errors, the Committee finds the number of mergers in mining and manufacturing to have increased from 89 in 1919 to 207 in 1928, or a total during the period of 1,268, involving 4,135 concerns which were merged, 3,114 which were acquired and 5,991 concerns which disappeared.

The most conspicuous trend toward consolidation has been in the field of public utilities. The whole story is as yet nowhere adequately recorded, but a tabulation appearing in the *Electrical World*, which at least does not overestimate the trend, shows that between 1919 and 1928, 4,329 public utilities disappeared, the tendency being at an increasing rate each year. That the disappearing corporations have been absorbed by existing utilities is indicated by the increased size of the average utility.

No longer than ten years ago the small town was a haven for the small business man. It had a variety of retail stores to serve its local clientele, including

grocers, drug, hardware, candy, haberdashery, vegetable, cigar, restaurants and hotels. It had many small industries; a locally financed electric and gas plant; a locally controlled trolley line; and frequently a number of distribution establishments for farm implements, automobiles, automobile accessories, service stations and a variety of building supply establishments. In brief, the town had a home business of its own and crowning this local business were a number of local independent banks organized, managed and financed by local business men, drawing the bulk of business, deposits and loans from the local community.

The economic changes heretofore outlined have changed the business aspect of the town. The most conspicuous example is the rapid disappearance of the independent store which is being replaced by chain store units. Into this new distributing organization have been swept the grocer, five and ten, candy, drug, cigar stores and in most recent years, even restaurants, haberdasheries, bakers, hotels and furniture dealers. The figures are impressive. We find that between 1919 and 1927 the annual index of chain store grocery sales has increased from 45 to 175; five and ten cent sales from 53 to 138, wearing apparel from 36 to 189, drugs from 64 to 143, cigar from 72 to 110, shoes from 76 to 115, candy from 53 to 119. The survey of eleven cities shows that 41% of grocery and delicatessen sales are made through chain stores. Chain groups sold 71 per cent of variety sales, 73 per cent of gas and oil, 44 per cent of dairy and poultry products, 51 per cent of men's hats and caps, 52 per cent of shoes, 36 per

cent of cigars, 37 per cent of millinery, 28 per cent of coal, wood and ice. The list, if extended, will more fully show the invasion of the chain store into the business of the small town and the grip it already has on the business of the local community.

When we study the history of any one of these chain stores, the same impression of a changing development in retail sales becomes apparent. For example, the nucleus of the United and Schulte combination was formed in 1902. At present the United Cigar Stores are spread over the entire continent and are interwoven with the D. A. Schulte Cigar Stores, making the largest chain in existence. They own the Schulte-United, 5 and 10 and $1.00 stores, the Whelan-Schulte interests and scores of other chain store enterprises that have since been annexed. They now include United Chemists, Happiness Candy, Park & Tilfords, Huylers, Leads Sandwich, Vivaudou and Djer-Kiss, making a nation wide chain of tobacco, drugs, sweets, food and perfumes.

Turning to another field, we find the Hahn Department stores in 1928 consolidating 22 department stores, and plans for department store mergers are under way which promise to be almost as important a formation in its field as the United States Steel or American Telephone and Telegraph are in theirs. Kroger has 5,260 retail stores doing a business of $207,000,000 a year; J. C. Penney has sales around 176 million dollars; Kresge, 147 million dollars; American Stores with 2,546 units have gross sales of 137 million dollars; the United Drug Company in 1927 handled 27 per cent of the drug business in the

United States through 10,000 Rexall and 464 Liggett stores; the National Tea Company have sales of 85 million dollars; the Safe-way Stores with 2,020 outlets sold $103,000,000 of its goods a year; McCrory's have sales of approximately 40 million dollars; and the Great Atlantic and Pacific Tea Company with 16,000 outlets has sales in excess of 900 million dollars.

Preceding and simultaneous with the development of these chain stores has been the continued pressure on local business by the aggressive, nation wide mail order houses, which in addition to the inroads made normally by their keen competition have begun to establish retail chain stores throughout the United States. Sears, Roebuck & Co. does a business of over four hundred million dollars, Montgomery Ward have annual sales of three hundred million dollars, both drawing heavily on business that would otherwise go to the independent merchant in the small towns.[2]

Nor is it at all certain that the independent merchants are independent in the full sense of the word. In order to compete with the growing chain store menace, unit stores have been compelled to unite and adopt some of the very principles successfully used by the chain stores. Group buying associations among independent stores of many towns have taken a foothold over wide regions; buyers' groups and other collective buying associations have united thousands of stores and incorporated into them many of the elements of chain organizations.

[2] Cf. "Troubled Waters of Distribution" by Marvin K. Black, Outlook, May 15, 1928.

In the grocery trade an outstanding example of the new cooperation among independent merchants is the Independent Grocers Alliance, a cooperative including 54 selected wholesalers operating in 26 states, having 120 warehouses with approximately 11,000 grocery outlets. Through this organization the independent grocer is given, by centralized purchasing, most of the advantages of his chain store competitor. The vital element in chain store operation is close careful supervision by headquarters over each individual unit. The stores in the group of Independent Grocers Alliance are given just as close supervision over all of their activities as the chain stores receive from headquarters, the members united in the group are carefully chosen and it is demanded that they comply with the minimum standards for successful merchandising put up by the cooperative alliance. Such a member receives instruction for decorating his store in conformity with the preconceived model of this particular group; it is painted ivory, trimmed in blue inside and out; all goods are marked and customer service is encouraged; a careful inventory of his goods is kept and only such supplies are placed on the shelves as have a rapid turnover; advertising is on a national scale conducted from headquarters. The gross annual income of this corporation is between 300 and 400 million dollars. By cooperation, by buying pools and central merchandising service, costs have been cut. It is to be remembered that this is only one of scores of equally large organizations that are sweeping so-called independent stores into cooperative groups. We have the American Retailers Asso-

ciation, the Associated Merchandising Corporation, the Drygoods Union of the Syndicate Trading Company and the National Retail Owned Wholesale Grocers Association comprising 15,000 individual retail stores. The recent merger of McKesson & Robbins, Inc. marks a serious attempt with a definite economic basis to bring together the independent drug owners under centralized management. Approximately 55 per cent of the druggists in the country do business regularly with the members of this new merger. It is needless to pursue this line of investigation. It leads to the one conclusion that the ostensibly independent store is not independent in the full sense of the word any more. That even its financial business affiliations are rapidly going to the metropolitan centers where the headquarters of the cooperatives exist.

If the economic structure of the town is changing from independently owned enterprises to units of large business corporations or cooperatives having their financial centers outside of the town, it becomes obvious that the business of the town bank is more and more confined and restricted to such business enterprises as are still remaining in the town and vicinity. Such enterprises are becoming fewer and progressively less profitable as the more successful enterprises join or are absorbed by the larger corporations. There remains for the banker that larger banking field which is an accessory to almost every town in the United States, namely, agriculture. Outside of the town and village, separated from it only by an artificial political line but included in the area of economic influence of the

town, are the vast open agricultural regions still the stronghold of independent small units. Six and a half million farmers are today the largest single group of independent small owners of business enterprises. In fact, our vast agricultural empire north, south, west and east has been financed and developed by the small independent bank for the benefit of the family-sized farm, the farm worked by the farmer, his wife and children, with only an occasional hired man. And this agricultural empire, having an investment of over 57 billion dollars constitutes today the chief and in many towns almost the only client of the country banks.

But while agriculture in the United States in the aggregate is one of the leading industries, having one of the largest investments in capital and in value of products and demanding financial service second to no industry in the country; this supremely important industry has paid to its workers lower wages than are received by unskilled labor and so low a return on invested capital that paper based on agricultural security has ceased to be desirable bankable assets. Agriculture has been a depressed industry; in fact, over many sections of the country agriculture is in a semi-bankrupt state.

Moreover, even here the cream of the business has been taken away from the local bank. State and regional commodity cooperative marketing associations are today being financed directly through finance corporations of the cooperatives or through banking facilities in the metropolitan centers. The best farm mortgages are being financed through the Federal Loan banks. Such short term paper as has

ample security back of it, finds its way for discount through the Intermediate Credit Banks. Also, the development of roads, the increase in the use of the automobile, the quickened communication has diminished the local banker's business precisely in the same way that it has taken desirable business away from the small town merchant to the larger centers. In fact the automobile has abolished hundreds of communities and has reduced others to a point where they can no longer support the once prosperous bank. The large amount of frozen assets, third and second farm mortgages and short time farm notes in the hands of local banks, an amount running into many millions and virtually irredeemable and certainly in no sense bankable papers, today forms the chief burden on the credit strains of the country bank.

In brief, the banking business in the small town has deteriorated. Neither within the town nor outside in the farm areas is the best banking business attracted to the small town bank. The forces, at work in the small communities, centralizing business in metropolitan areas, are leaving the small community barren as a financial field in which an independent local bank may profitably operate.

The banking system, as will be shown later, has been unchanged in its most characteristic and fundamental features since its inception, almost a hundred years ago. But now it is confronted with centralizing forces in industry and the rapid disappearance of small independent enterprises. The stress of these industrial conditions is bringing about two distinct forms of development. First, in

response to the concentration of industry in the metropolitan centers there is developing a concentrated form of banking business. Second, because of the distressed condition of the banks in the smaller towns, these banks are being grouped together in chains, or are rapidly being suspended as their banking service becomes less profitable.

## CHAPTER II

### Metropolitan Bank Mergers

THE consequence of the business revolution, in which business and industry are being concentrated into metropolitan centers and in which there is being substituted for the independent business unit in the small town a segment of large central organizations, is the creation of a banking system adequate to serve these new business interests. Within the metropolitan centers, banking during the past half century has failed to meet the growing financial needs of converging business enterprises. The legal loaning capacity of any one bank to any one borrower, individual or corporate, is 10 per cent of its capital and surplus. In 1926 the largest bank in the United States had a capital and surplus of 90 million dollars, and thus could extend a maximum loan of 9 million dollars to any one borrower. While this seems a sizable loan, it was wholly inadequate in face of such business enterprises as Sears, Roebuck & Company with total sales in 1928 of 347 million dollars, Woolworth Company with sales of 287 million dollars, and Kroger Stores with sales of 207 million dollars and hundreds of other new merchandising enterprises whose annual sales run well into nine figures, to say nothing of such corporations as General Motors, United

States Steel or United States Rubber Company, whose annual business runs to a billion dollars.

In modern financing these corporations probably make no such definite bank loans as is here suggested and it is probably true that much of their financing is done through surplus funds and stock issues, but it is also true that occasionally these corporations find it necessary to secure large bank loans and in any event find it desirable to keep their credit lines open. These corporations, therefore, find that the legal loaning capacity of any one bank is limited to a figure much below their probable needs. Hence it is necessary for them to maintain open credit accounts in several banks, and they are of necessity compelled to distribute their bank business among the several banks with which they carry an open credit. They divide their deposits among these banks and also make a division of investment opportunities to be offered through banks.

In other words, the metropolitan banks are frequently compelled to forego business because they are too small to handle it, and because they have not grown apace with the expanding, industrial organization. The cramped position of the bank, relative to modern business, is not merely technical from the single borrower standpoint. The very increase in bank business compels expansion of banking facilities. Capital and surplus limits the amount of business a bank can digest, and banks with an underlying capitalization of less than 10 per cent of total resources are considered in a less sound position.

Paul M. Warburg, Chairman of the Board of

Directors of the International Acceptance Bank, gives the reasons for the merger with the Manhattan Company as follows:

"I believe it is safe to say that the revolution in the industrial field, to a certain degree at least, is responsible for a similar development in the field of banking, because the gigantic form assumed by industrial corporations on both sides of the Atlantic renders their banking requirements so large and so all encompassing, that only banks with gigantic resources of their own are able to offer them commensurate facilities."

The metropolitan banks have met this situation by increasing the underlying capitalization and by bank mergers. Illustrations of the tendency are abundant but are in danger of being superseded by new figures by the time these lines reach the readers. During the first quarter of 1929, 42 bank mergers alone involved total assets of 12 billion dollars, or more than one-sixth of the total banking assets in the United States. From a peak of 30,812 national and state banks in 1921, the number of banks declined to 25,961 in 1929; but during the same period the resources of all banks increased from 56.6 billion dollars to 73 billion dollars, an increase of 30 per cent, or from an average of $1,612,100 to $2,814,100, an increase of 74 per cent for each bank.

A recital of a series of individual accretions in capitalization and resources similarly points to the tendency towards larger banks in the metropolitan districts. The National City Bank, early in 1925, increased its capital from 40 to 50 million dollars and its surplus from 55 to 61 million dollars (see Table I); in 1927 the capital was again increased

## TABLE I

### Growth of Capital, Surplus and Deposits of Metropolitan Banks

| | Capital and Surplus, Thousands of Dollars | | Per Cent Increase | Deposits, Thousands of Dollars | | Per Cent Increase |
|---|---|---|---|---|---|---|
| | Jan., 1924 | Oct., 1929 | | Jan., 1924 | Oct., 1929 | |
| National City Bank, New York | $ 91,903 | $ 238,000 | 159% | $ 602,055 | $ 1,500,063 | 149% |
| Chase National Bank, New York | 43,707 | 241,204 | 452% | 309,832 | 995,239 | 221% |
| Guaranty Trust Co., New York | 43,407 | 288,809 | 565% | 441,769 | 1,197,589 | 171% |
| Continental Illinois Bk. & Trust, Chicago | 44,760 | 144,275 | 222% | 366,928 | 880,675 | 140% |
| Bankers Trust Co., New York | 44,020 | 107,753 | 145% | 261,366 | 485,956 | 86% |
| Irving Trust Co., New York | 46,419 | 132,750 | 186% | 300,668 | 514,544 | 71% |
| Equitable Trust Co., New York | 32,986 | 90,999 | 176% | 277,523 | 634,876 | 129% |
| First National Bank, New York | 69,319 | 112,357 | 62% | 194,912 | 333,896 | 71% |
| Manufacturers Trust Co., New York | 10,047 | 85,508 | 751% | 104,364 | 387,108 | 271% |
| First National Bank, Chicago | 29,661 | 52,699 | 78% | 216,091 | 372,305 | 72% |
| Security Trust Co., Los Angeles | 13,599 | 51,082 | 276% | 188,050 | 532,421 | 183% |
| Bank of America of Calif., San Francisco | 17,513 | 17,782 | 2% | 78,547 | 82,460 | 5% |
| Bank of Italy, N.T. & S.A., San Francisco | 21,228 | 106,254 | 401% | 276,549 | 705,141 | 155% |
| American Trust Co., San Francisco | 3,960 | 20,801 | 425% | 24,453 | 254,788 | 942% |
| First National of Boston, Boston | 35,930 | 59,161 | 65% | 229,838 | 358,434 | 56% |
| Peoples State Wayne Co., Detroit | 15,312 | 39,161 | 156% | 111,335 | 265,674 | 139% |
| Bank of America, N.A., New York | 12,105 | 75,056 | 520% | 84,518 | 261,453 | 209% |
| Bank of Manhattan Co., New York | 23,676 | 65,478 | 177% | 127,426 | 251,502 | 97% |
| Corn Exchange Bank, New York | 22,001 | 34,904 | 59% | 179,111 | 221,071 | 23% |
| Central Hanover Bk. & Tr. Co., New York | 34,333 | 100,034 | 191% | 190,257 | 529,534 | 178% |
| New York Trust Co., New York | 28,343 | 46,548 | 64% | 198,076 | 254,702 | 29% |
| Union Trust Co., Cleveland | 34,428 | 39,855 | 16% | 237,204 | 305,361 | 29% |
| Philadelphia National Bank, Philadelphia | 16,773 | 36,815 | 119% | 101,122 | 138,130 | 37% |
| Total 23 banks | $735,430 | $2,187,285 | 197% | $5,101,994 | $11,462,922 | 125% |

The 23 metropolitan banks increased their capital, surplus and undivided profits 197 per cent from January, 1924, to October, 1929, and their deposits 125 per cent.

to 75 million dollars and the surplus to about 70 million, making a total capital and surplus of 145 million dollars. This total was again increased early in 1928 to 162 million dollars, again by means of mergers in March, 1929, to 212.6 million dollars and again in October, 1929, to 270 million dollars. During this period (1924 to September, 1929) the deposits grew from 600 million dollars to 1.5 billion dollars, an increase in five years of 149 per cent.

The Guaranty Trust Company started the year 1924 with 43.4 million dollars in capital and surplus, and in September, 1929, had 278 million dollars. During the same period the deposits increased from $441,769,000 to $1,197,589,000. The increases, as in the case of the National City Bank, were made in part by increasing the capitalizations and reserves and partly by mergers.

The Chase National Bank grew by merger and by increased capitalization from 43 million dollars capital and surplus in 1924 to 242 million dollars in 1929, with deposits increasing during this period from 310 million to 800 million dollars. Twenty-three banks in eight cities increased their capitalization during the five years 197 per cent and their deposits 125 per cent (see Table I). The total capitalization of these banks during this period increased 295 per cent, from 747.7 million to 2.2 billion dollars; and their deposits increased 212 per cent, from 5.1 to 11 billion dollars.

In consequence of these mergers and increasing capitalization of banks, 12 cities have approximately 47 per cent of the total bank deposits of the entire country (see Table II). There were in July, 1929,

## TABLE II

### Large Bank Mergers and Their Effect Upon the National Banking System

This table lists the effects of bank mergers in the twelve largest cities during the past five years (up to July 22, 1929):

| Cities in Order of Greatest Deposits | No. of Banks Growing by Mergers | No. of Banks Eliminated by Mergers | Total Banks with over 50 Million Deposits |
|---|---|---|---|
| New York | 13 | 36 | 40 |
| Chicago | 4 | 8 | 8 |
| Philadelphia | 8 | 15 | 9 |
| Boston | 3 | 4 | 11 |
| San Francisco | 4 | 8 | 10 |
| Cleveland | 1 | 1 | 4 |
| Pittsburgh | 2 | 2 | 5 |
| Los Angeles | 5 | 12 | 6 |
| Detroit | 3 | 5 | 4 |
| St. Louis | 4 | 6 | 3 |
| Buffalo | 3 | 5 | 5 |
| Baltimore | 2 | 6 | 3 |
| Totals | 52 | 108 | 108 |

The above twelve cities have approximately 47 per cent of the total bank deposits of the entire country.

There are now three banks with deposits over one billion dollars each, twelve with over 500 million and 108 with over 50 million.

The 1929 mergers in these twelve cities have taken twelve large banks out of the national system. These banks had resources of $2,758,109,330. On the other hand, the 1929 mergers have added six large banks to the national system with resources of $791,495,990. The net loss to the national system, therefore, is six banks and resources of $1,996,613,340.

three banks with over one billion dollars deposits, twelve with over 500 million and 108 with over 50 million dollars. In the national banking system, at the end of 1928 (see Table III), seven banks with

TABLE III

CAPITAL AND RESOURCES CONCENTRATION IN NATIONAL BANKS

This table indicates the Invested Capital and Total Resources concentration by size of bank groups of national banks as at December 31, 1928:

| Capital | No. of Banks | % | Invested Capital, Thousands | % | Total Resources, Thousands | % |
|---|---|---|---|---|---|---|
| Less than $ 50,000 | 2158 | 28.2 | $ 109,963 | 3.1 | $ 912,195 | 3.0 |
| 50,000– 200,000 | 4062 | 53.2 | 709,511 | 19.7 | 5,519,769 | 18.0 |
| 200,000– 500,000 | 927 | 12.1 | 504,655 | 14.0 | 4,080,436 | 13.3 |
| 500,000– 1,000,000 | 249 | 3.3 | 291,519 | 8.1 | 2,337,702 | 7.7 |
| 1,000,000– 5,000,000 | 205 | 2.7 | 676,187 | 18.8 | 5,848,063 | 19.1 |
| 5,000,000– 25,000,000 | 27 | 0.4 | 634,426 | 17.6 | 5,695,528 | 18.6 |
| 25,000,000–and more | 7 | 0.1 | 672,042 | 18.7 | 6,195,463 | 20.3 |
| Totals..... | 7635 | 100.0 | $3,598,303 | 100.0 | $30,589,156 | 100.0 |

It is interesting to observe that although the small banks (with a capital of less than $50,000—2,158 in number) represent 28.2 per cent of the total *number*, yet they have only 3.1 per cent of the total invested capital and but 3 per cent of the total resources of the entire system.

At the other extreme we find seven banks with a capital of $25,000,000 and over, and although they are but 0.1 per cent of the total *number*, yet they have 18.7 per cent of the total invested capital and 20.3 per cent of the total resources.

capitalization of 25 million dollars each and over, although but 0.1 per cent of the total number, had 18.7 per cent of the total invested capital and 20.3 per cent of the total resources.

The centripetal forces, as illustrated by these mergers, which centralize capital in the metro-

politan cities of the United States, have their origins in new business tendencies outlined before, but these economic forces, while probably most important, are supplemented by other centralizing tendencies. Mergers in the larger cities have taken place for a variety of reasons. One important cause is the diversification of business secured by such mergers. The merger of the National City Bank, a bank given over partly to the promotion of investments, with the Farmers' Loan and Trust Company, an institution which for over a hundred years has been known as a repository of funds and which has entrusted to it the administration of many of the old and great estates in the country, was influenced by the fact that they supplement each other's activities and diversify their banking business.

There are mergers for the purpose of taking over smaller banks or avoiding failures. It is not improbable that just as in the smaller towns too many banks have developed for the banking needs, so an over-development in the larger cities has taken place, thus encouraging their reduction by absorption of the weaker units by stronger banks. The importance attached to a name is illustrated in the acquisition of the Bank of America, which it has been asserted was taken over by the Giannini interest because they, having become important factors in many banks throughout the country, were anxious to head the group with a name "Bank of America," that that adequately defined their banking aspirations. Subsequently the Bank of America took over the Nassau National Bank of Brooklyn in order, according to the announcement,

to extend its branches. It is entirely probable that a similar force actuated the successive merging of fourteen banks in thirteen years into the present Manufacturers' Trust Company of New York and also the series of eight consolidations involving twenty-four once independent banks which produced the present Irving Trust Company of New York, in each case the favorable location or the type of banking business of the unit making an important asset to the central institution.

Banks with central offices in the financial district have merged in order to acquire branch banks in New York City, a process that has been facilitated for the national banks by the McFadden Bank Act, to be discussed later. The International Acceptance Bank, an institution with important foreign connections, has recently been merged with the Bank of Manhattan, one that is largely local but has branches widely scattered throughout the metropolitan district of New York. The merging of the Chase National Bank with the American Express Company illustrates the endeavor of a New York Bank to reach additional foreign business through the draft department of the express company.

It is not improbable that many bank mergers had no economic urge but were influenced by a mere desire for bigness. The National City Bank was sufficiently conscious of this charge to make a specific denial that desire to be the largest bank in the United States had any influence on the several 1929 absorptions. It is not infrequently argued that many mergers have doubtful economic basis and are tak-

ing place merely to gratify officers who desire to preside over larger institutions or feel they must go with the business tide which expects mergers.

It may be readily granted that all these have been factors of the merging process. But we finally return to our original premise that the development of large central banking institutions by merger and by increased capitalization are in the main the resultant of forces outside the banking circles, are in fact the consequence of the new business era which is making for concentration of business in the metropolitan cities and demands banking services adequate to cope with the new gigantic industrial development.

Unification in industry has been going on in the United States for over half a century and has met with varying intensity of political and social resistance. Antitrust laws are on the statute books of virtually every state, and on the federal statute books are almost half a century old. But the banking system, until recently, has remained practically unchanged. It is only within the past few years that the renewed impetus to newer and still larger industrial mergers called for similar response from the banks. Financial institutions in Europe had commenced to centralize on a large scale just before, during and immediately after the war, and from them has flown to the new and larger industry the abundance of life-giving credit. It is not unfair to say that from the standpoint of banking, America is today where Europe was immediately after the war when there began the large banking amalgamations which finally resulted in the emergence of The

Big Five in England, a Big Four in Germany, bank concentration in France, Japan and in other industrial countries. In 1918 the Midland Bank, in England, absorbed the London Joint Stock Bank with 303 branches; Lloyds absorbed the National Bank of Scotland, the London and River Plate Banks, the Brazilian Bank and the Bank of British West Africa. The merging movement continued unabated for some years after until we come to the present concentration of the United Kingdom banking institutions. The amalgamation of banks in the United Kingdom was looked upon with the same distrust as were the earlier trust movements in the United States. In 1918 the government appointed a Treasury Committee on Bank Amalgamation whose purpose it was "to consider and report to what extent, if at all, amalgamations between banks may affect prejudicially the interests of the industrial and mercantile community, and whether it is desirable that legislation should be introduced to prohibit such amalgamations or to provide safeguards under which they might continue to be permitted."

In part the committee made the following report:

"The committee looked upon amalgamation up to a certain point as wise and necessary to finance the large scale enterprises resulting from the war. Although, in the past, we believe that amalgamations have not, in most instances, led to a reduction of bank competition yet . . . amalgamations between large joint-stock banks must now usually mean a net reduction in the number of competing banks. It is true that this reduction is only slight in each case and that there still remains at present a fair number of competing banks. But we have received

representation from certain municipal corporations to the effect that banks vary very much in their willingness to allow reasonable overdraft facilities to corporations, and that sufficient money, and cheap enough money, has only been obtained hitherto by resorting to different banks, the number of which is now falling steadily. On this ground a number of resolutions have been forwarded to us by corporations protesting against further amalgamations and suggesting that it is not in the national interest that large funds belonging to the public should be in the hands of a few companies."

The committee further notes the complaint made that the reduced number of Discount Houses reduces the flexibility of the market and the sensitiveness of the rates for London bills which have given "world wide fame" to the London Money Market. After discussing the danger of a "money Trust" inherent to such important amalgamations, the committee finds:

"While we believe that there is at present no idea of a Money Trust it appears to us not altogether impossible that circumstances might produce something approaching it at a comparatively early date."

The Committee concluded with the following recommendations:

"That legislation be passed requiring that the prior approval of the government must be obtained before any amalgamations are announced or carried into effect. . . . that all proposals for interlocking directorates, or for agreements which in effect would alter the status of a bank as regards its separate entity and control, or for purchase by one bank of the shares of another bank be also submitted for the prior approval of the Government

before they are carried out . . . that amalgamation designed to secure important new facilities for the public or a really considerable and material extension of area or sphere of activity for the larger of the two affected banks affected should normally be considered favourably, but that if an amalgamation scheme involves an appreciable overlap of area without securing such advantages . . . it should be refused."

The bank mergers in the metropolitan areas of the United States differ from the English mergers in that no branch banks beyond city limits are as yet involved. The same forces that produced a consolidation of the United Kingdom banking system are operative here and the fears for an ultimate "Money Trust," though as yet not discernible, are beginning to be voiced by timid souls. Moreover, this process of increasing capitalization and merging of metropolitan banks is wholly independent of a concurrent process of unification of banks into chains or groups by means of holding companies. This development, which at present is not allied with large central banks, is also in response to rapidly changing economic needs and is the outcome of pressure put on smaller metropolitan banks to finance large scale production and distribution and the consequence of the distressed condition of the small town bank. This phase will be discussed more fully later. We note here that the concentration of capital into veritable financial empires, under the leadership of a relatively small number of banks situated in our larger cities, has already gained formidable proportions and is wholly within the intent and theory of the law, and as yet has called forth no important

legislative objection. Disregarding any other movement, such as chain banking, group banking or branch banking, when one-tenth of one per cent of our banks control one-fifth of the bank resources of the country, the theory of the independent unit bank is already being hard pressed as a workable basis for a banking system.

## CHAPTER III

### The Critical Position of the Country Banks

WHILE the metropolitan cities have had centered in them the industrial and financial resources of the country, the banks in the smaller towns have seen the substantial deposits of independent merchants and business men replaced by fleeting and unprofitable deposits of the chain store manager. Opportunities for extending bank loans to local business enterprises are thus restricted more and more to the field of business not taken over by centralized agencies, and on the whole, one that is less liquid, less desirable and less safe. Inferior banking business coupled with less skilled management has caused the suspensions, between 1920 and 1928, of 4,513 banks out of 30,078 in operation June, 1920. The capital of the suspended banks amounted to $169,004,000 and deposits $1,350,603,000 (see Table IV). Although comprising 15 per cent in number of all banks, these suspended banks aggregated only 6.3 per cent of the total bank capital and 3.3 per cent of the total deposits. The significance of these figures is not in the financial importance of the banks; in fact their assets are relatively unimportant. The significance lies in the fact that it is the rural district only that is served with an unsound banking system, as is clearly revealed when it is

# BANK SUSPENSIONS
DURING EIGHT YEAR PERIOD — 1921-1928 INCLUSIVE
## BY SIZE OF CAPITAL STOCK

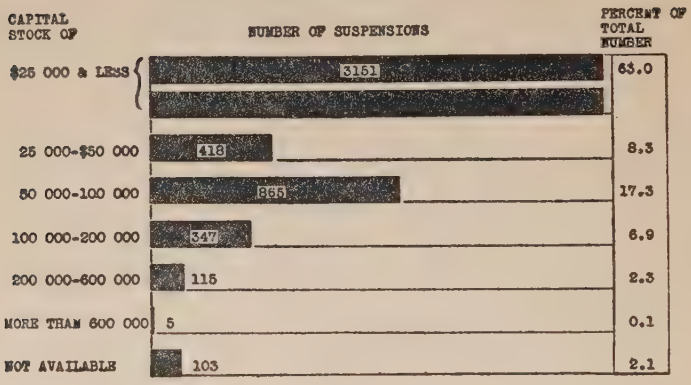



CHART I.

# BANK SUSPENSIONS
DURING EIGHT YEAR PERIOD — 1921-1928 INCLUSIVE
## BY SIZE OF TOWN OR CITY

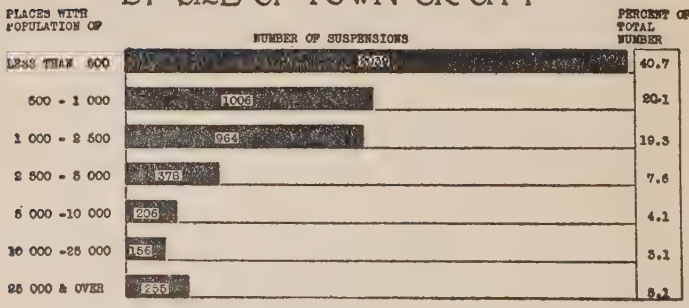



CHART II.

noted that 88.6 per cent (see Chart I) of these failures were of banks with capitalization of $100,000 or less, and that 87.7 per cent occurred in communities with a population of 5,000 or less (see Chart II). This refinement of figures for total bank failures, therefore, isolates bank suspensions to the small banks in the smaller communities, the towns from which individual business enterprise has departed. During the eight-year period under discussion, from 1920 to 1928, a period of unparalleled industrial prosperity, 53.9 per cent of all the banks in South Dakota were suspended; 49.6 per cent in Montana and New Mexico; 40.6 per cent of the banks in South Carolina; North Dakota, Georgia, Florida, Wyoming and Arizona suspended between 30 and 40 per cent of their banks; Minnesota, Iowa, Oklahoma and Colorado suspended between 20 and 30 per cent; Missouri, Nebraska, Kansas, North Carolina, Arkansas, Louisiana, Texas, Utah, Washington and Oregon suspended between 10 and 20 per cent. Only Vermont, Delaware and the District of Columbia showed no bank suspensions during this period (see Table V).

The situation here outlined violates the first principle of any banking system worthy of the name. Primarily the function of a bank is to act as custodian, as a safe repository for the funds entrusted to it. Within limits, it is expected that these funds are invested through liquid loans to clients, thus permitting the bank to make a sort of broker's profit and give the depositors a small interest return on their money. The bank fundamentally has two functions: (1) it seeks deposits and (2) it seeks in-

vestments for these deposits. But primarily the deposits must be safe and returnable to depositors. The theory on which the United States Banking System is established, according to federal and most state laws, is that each bank should be a local institution, locally financed and managed, drawing funds from local depositors and using its financial resources for the development of local business enterprises.

The theory is based on the assumption that the financial independence of the local community is the prime consideration of a banking system. Contrasts are made between the aggressive development of the American Northwest with a banking system founded on local interests, and that of Canada, where local banks are branches in the hands of

TABLE IV

BANK SUSPENSIONS, SEVEN-YEAR PERIOD, 1921–1927

The number of banks suspended and reopened during the seven year period, by years, and their capital and deposits, are shown in the following table (capital and deposits in thousands of dollars):

| | Banks Suspended | | | Banks Reopened | | |
|---|---|---|---|---|---|---|
| | No. | Capital | Deposits | No. | Capital | Deposits |
| 1921 | 502 | $ 22,902 | $ 198,354 | 60 | $ 1,918 | $ 17,493 |
| 1922 | 354 | 13,743 | 110,721 | 65 | 4,003 | 35,565 |
| 1923 | 650 | 21,978 | 188,805 | 36 | 1,506 | 11,567 |
| 1924 | 777 | 28,373 | 213,444 | 94 | 2,815 | 22,462 |
| 1925 | 612 | 24,441 | 172,900 | 62 | 1,994 | 16,616 |
| 1926 | 956 | 32,804 | 272,488 | 147 | 5,099 | 60,180 |
| 1927 | 662 | 24,763 | 193,891 | 95 | 3,906 | 35,729 |
| Total | 4,513 | $169,004 | $1,350,603 | 559 | $21,241 | $199,612 |

The following table indicates the distribution of suspensions between national, state member and non-member banks, during the seven-year period (capital and deposits in thousands of dollars):

| | Number | Capital | Deposits |
|---|---|---|---|
| All banks: | | | |
| Suspended | 4,513 | $ 169,004 | $ 1,350,603 |
| Reopened | 559 | 21,241 | 199,612 |
| In operation in June, 1920 | 30,078 | 2,682,752 | 41,445,018 |
| Ratio of suspensions to banks in operation | 15.0% | 6.3% | 3.3% |
| National banks: | | | |
| Suspended | 642 | 38,070 | 287,154 |
| Reopened | 88 | 4,685 | 37,481 |
| In operation in June, 1920 | 8,025 | 1,223,416 | 17,148,231 |
| Ratio of suspensions to banks in operation | 8.0% | 3.1% | 1.7% |
| State bank members: | | | |
| Suspended | 198 | 14,928 | 107,701 |
| Reopened | 19 | 1,270 | 12,796 |
| In operation in June, 1920 | 1,374 | 493,628 | 8,224,105 |
| Ratio of suspensions to banks in operation | 14.4% | 3.0% | 1.3% |
| Non-members (including private): | | | |
| Suspended | 3,673 | 116,006 | 955,748 |
| Reopened | 452 | 15,286 | 149,335 |
| In operation in June, 1920 | 20,679 | 965,708 | 16,072,682 |
| Ratio of suspensions to banks in operation | 17.8% | 12.0% | 5.9% |

agents of larger central institutions. The comparison is apt in many respects, though it is not as disadvantageous to Canada as would at first appear and will be discussed more fully later. But a banking system is fundamentally designed

for the safeguarding of funds not for community development. A sound local bank contributes to local progress, but the stability of the bank is the chief consideration and local development is secondary. In fact, the loss of banking prestige inevitably brings in its wake the impotence of the bank as a local financial factor. In one state where public confidence in the banking system has been shattered by an extraordinary number of suspensions, the deposits of Postal Savings increased 7,000 per cent during the last two years, thus withdrawing deposits from the local weak units and placing them in control of agencies outside the town. By placing development before stability the whole banking system is being called into question, and throughout large sections of the country confidence in the banks has been seriously impaired with consequent deposit withdrawals, decreased credits and reduced assets sorely needed to liquefy local investments.

It would not be within the facts to ascribe these large numbers of bank failures solely to a changing industrial development that is taking from the local community the more lucrative banking business. To be sure that is an important cause, but in face of progressively disadvantageous conditions, there have been in every state of the Union small banks in small communities that have been making profits. An important contributing factor to bank failures has been the depression in agriculture throughout the United States. That the agricultural depression bore heavily on the banks is indicated by the Annual Report of the Federal Farm Loan Board, which in-

dicates that in 1928 [1] the Federal Farm Loan Banks had acquired by foreclosure 2,652 farms valued at $14,634,588 and that the Joint Stock Land Banks during this period also acquired 2,626 farms valued at $31,688,139, making the ratio of foreclosures to loans since the organization of these systems about 3.5 per cent. These figures do not include the foreclosed farms held by state banks, finance or insurance companies. Estimated on the basis of total value of foreclosed farms in the hands of the Farm Loan Banks, the farms foreclosed and held by Life Insurance Companies would be valued at about 60 million dollars. The amount of frozen assets now held by the Farm Loan Banks, amounting to about 50 million dollars, is therefore only a part of the non-liquid security held by country banks since each bank has relatively large non-liquid loans of its own outstanding. A safe guess is that these loans far exceed the frozen loans of the Farm Loan Banks and Life Insurance Companies. In addition to the large numbers of foreclosed farms in the hands of banks, there must be many millions of dollars' worth of paper secured by first, second and third mortgages, that are in no sense liquid or bankable, and an additional large amount of notes by farmers secured only by the hope for a good crop and good prices. These conditions, on the average, have not obtained for many years. It must be presumed from these figures that both state and federal bank examiners must adjust their examinations to local conditions. Much of the paper held by the banks is, no doubt, recognized by the examiners as non-

[1] 12th Annual Report of Farm Loan Board, p. 22.

TABLE V

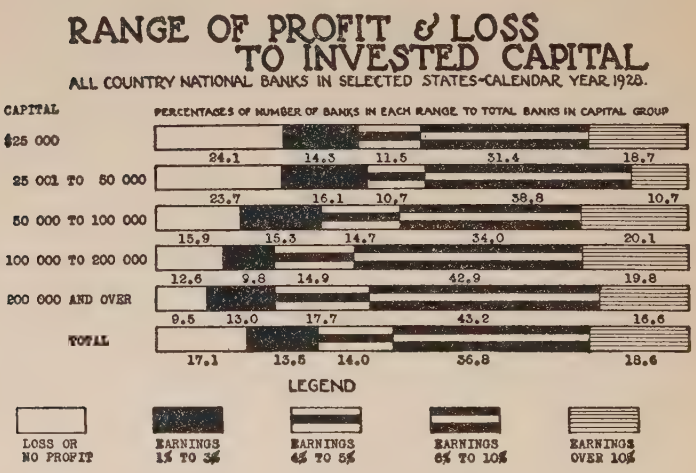
NUMBER AND PERCENTAGE OF BANK SUSPENSIONS BY STATES

| State | Total Number of Banks 6-30-20 | Number of Suspensions 1921-1927 incl. | Per Cent Suspensions to Banks 6-30-20 |
|---|---|---|---|
| No Suspensions: | | | |
| Vermont | 108 | 0 | 0 |
| Delaware | 47 | 0 | 0 |
| District of Columbia | 45 | 0 | 0 |
| 0.1 to 5.0 Per Cent Suspensions: | | | |
| Maine | 161 | 2 | 1.9 |
| New Hampshire | 125 | 1 | 0.8 |
| Massachusetts | 465 | 6 | 1.3 |
| Rhode Island | 48 | 2 | 4.2 |
| Connecticut | 220 | 4 | 1.8 |
| New York | 1,056 | 18 | 1.7 |
| New Jersey | 388 | 2 | 0.5 |
| Pennsylvania | 1,546 | 33 | 2.1 |
| Ohio | 1,145 | 36 | 3.1 |
| Maryland | 282 | 9 | 3.2 |
| West Virginia | 340 | 14 | 4.1 |
| Nevada | 33 | 1 | 3.0 |
| California | 723 | 27 | 3.7 |
| 5.0 to 10.0 Per Cent Suspensions: | | | |
| Indiana | 1,057 | 67 | 6.3 |
| Illinois | 1,610 | 90 | 5.6 |
| Michigan | 700 | 57 | 8.1 |
| Wisconsin | 976 | 58 | 5.9 |
| Virginia | 488 | 29 | 5.9 |
| Kentucky | 584 | 34 | 5.8 |
| Tennessee | 546 | 50 | 9.2 |
| Alabama | 352 | 21 | 6.0 |
| Mississippi | 354 | 29 | 8.2 |

TABLE V (*Continued*)

| State | Total Number of Banks 6–30–20 | Number of Suspensions 1921–1927 incl. | Per Cent Suspensions to Banks 6–30–20 |
|---|---|---|---|
| 10.1 to 20.0 Per Cent Suspensions | | | |
| Missouri | 1,652 | 242 | 14.6 |
| Nebraska | 1,196 | 140 | 11.7 |
| Kansas | 1,349 | 185 | 13.7 |
| North Carolina | 623 | 99 | 15.9 |
| Arkansas | 487 | 70 | 14.4 |
| Louisiana | 267 | 34 | 12.7 |
| Texas | 1,582 | 266 | 16.8 |
| Utah | 133 | 16 | 12.0 |
| Washington | 394 | 47 | 11.9 |
| Oregon | 277 | 39 | 14.1 |
| 20.1 to 30.0 Per Cent Suspensions: | | | |
| Minnesota | 1,515 | 334 | 22.0 |
| Iowa | 1,763 | 443 | 25.1 |
| Oklahoma | 959 | 241 | 25.1 |
| Colorado | 403 | 81 | 20.1 |
| 30.1 to 40.0 Per Cent Suspensions: | | | |
| North Dakota | 898 | 356 | 39.6 |
| Georgia | 738 | 261 | 35.4 |
| Florida | 265 | 92 | 34.7 |
| Idaho | 222 | 67 | 30.2 |
| Wyoming | 160 | 59 | 36.9 |
| Arizona | 87 | 27 | 31.0 |
| Over 40.0 Per Cent Suspensions | | | |
| South Dakota | 694 | 374 | 53.9 |
| South Carolina | 461 | 187 | 40.6 |
| Montana | 431 | 201 | 46.6 |
| New Mexico | 123 | 61 | 49.6 |

bankable in any sense of the word. Nevertheless, it is expedient to permit the paper to be classed among the bank's assets in the hope that the farmer will make good and will liquefy these insecure assets. To declare much of this paper worthless from the


RANGE OF PROFIT & LOSS TO INVESTED CAPITAL
ALL COUNTRY NATIONAL BANKS IN SELECTED STATES-CALENDAR YEAR 1928.
CAPITAL
PERCENTAGES OF NUMBER OF BANKS IN EACH RANGE TO TOTAL BANKS IN CAPITAL GROUP
$25 000
24.1 14.3 11.5 31.4 18.7
25 001 TO 50 000
23.7 16.1 10.7 38.8 10.7
50 000 TO 100 000
15.9 15.3 14.7 34.0 20.1
100 000 TO 200 000
12.6 9.8 14.9 42.9 19.8
200 000 AND OVER
9.5 13.0 17.7 43.2 16.6
TOTAL
17.1 13.5 14.0 36.8 18.6
LEGEND
LOSS OR NO PROFIT
EARNINGS 1% TO 3%
EARNINGS 4% TO 5%
EARNINGS 6% TO 10%
EARNINGS OVER 10%

| | NUMBER OF BANKS WITH CAPITAL OF | | | | | |
|---|---|---|---|---|---|---|
| PROFIT RANGE | $ 25 000 | $ 25 001 to $ 50 000 | $ 50 000 to $100 000 | $100 000 to $200 000 | $200 000 & OVER | TOTAL |
| LOSS OR NO PROFIT | 98 | 22 | 77 | 44 | 16 | 257 |
| EARNINGS 1% to 3% | 58 | 15 | 74 | 34 | 22 | 203 |
| EARNINGS 4% to 5% | 47 | 10 | 71 | 52 | 30 | 210 |
| EARNINGS 6% to 10% | 128 | 36 | 168 | 150 | 73 | 552 |
| EARNINGS OVER 10% | 76 | 10 | 97 | 69 | 28 | 280 |
| TOTAL NUMBER OF BANKS | 407 | 93 | 484 | 349 | 169 | 1 502 |

CHART III.

banking standpoint, as, no doubt, it is, would necessitate the closing of thousands of additional banks.

In fact, we get an additional glimpse of the critical condition of the smaller banks in the agricultural

region when we examine the earnings of banks in these sections. In a survey of all country national banks in a selected number of states (see Chart III) out of a total of 407 banks 17.1 per cent showed a loss or no profit, 13.5 per cent more earned less than 3 per cent on the invested capital, and 14 per cent more made earnings between 4 and 5 per cent. In sum, 44.6 per cent of the banks under investigation did not justify their economic existence. If these banks are further subdivided according to size, we find that 59.9 per cent, or almost three-fifths, of the banks with capitalization of $25,000 had losses or earned less than 5 per cent on their invested capital; included in this group were over one-half of the banks capitalized between $25,000 and $50,000; and considerably over two-fifths of the banks with capitalization between $50,000 and $100,000.

If we examine the national banks as a group in states, we find (see Table VI) that in 1928 the per cent additions to profits on capital and surplus was 1.81 per cent for all national banks in Iowa; 2.45 per cent for all national banks in Arizona, a state which showed consolidated national bank losses for the past six consecutive years; 3.69 per cent for Nevada; 4.22 per cent for Colorada; 4.88 per cent for Kansas; 2.77 per cent for North Dakota; 4.28 per cent for Missouri; 3.63 per cent for Florida; and 4.63 per cent for Georgia. In most of these states, this melancholy picture of earnings is for the country banks exclusively, the banks in the larger cities being listed separately. Moreover, 1928 was a better year for banks in many states than any for a decade

## TABLE VI

TRENDS OF EARNINGS RATIOS BY FISCAL YEARS ENDED JUNE 30, 1921 TO 1928, INCLUSIVE. AVERAGES OF NATIONAL BANKS IN STATES AND CITIES. RATIO CALCULATIONS BASED ON DOLLAR FIGURES COMPILED BY THE BUREAU OF THE COMPTROLLER OF THE CURRENCY.

| Cities States Territories | Per Cent Net Additions To Profits To Capital and Surplus (–Italics Denote Deficit) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1921 | 1922 | 1923 | 1924 | 1925 | 1926 | 1927 | 1928 |
| Maine | 8.73 | 9.94 | 11.57 | 9.90 | 9.68 | 12.82 | 14.42 | 13.05 |
| New Hampshire | 7.82 | 9.38 | 9.45 | 8.89 | 9.50 | 9.09 | 10.02 | 10.36 |
| Vermont | 5.68 | 8.59 | 9.86 | 9.14 | 9.83 | 10.40 | 9.32 | 9.79 |
| Massachusetts | 8.68 | 7.63 | 8.58 | 9.82 | 8.98 | 9.14 | 9.11 | 12.10 |
| Boston | 8.39 | 3.58 | 6.78 | 3.03 | 5.46 | 9.01 | 4.31 | 6.60 |
| Rhode Island | 10.68 | 9.67 | 9.72 | 8.39 | 7.53 | 11.00 | 8.48 | 6.44 |
| Connecticut | 7.91 | 8.62 | 6.63 | 8.16 | 8.73 | 8.78 | 8.43 | 9.34 |
| Total New England States | 8.38 | 6.64 | 7.86 | 6.95 | 7.61 | 9.38 | 7.38 | 8.92 |
| New York[1] | 7.42 | 10.83 | 11.87 | 11.00 | 13.95 | 13.66 | 13.15 | 12.91 |
| Albany | 12.99 | 10.08 | 13.81 | 11.16 | 12.39 | 15.37 | 14.24 | .... |
| Brooklyn & Bronx | 14.01 | 12.23 | 10.11 | 7.50 | 8.41 | 12.76 | 3.11 | 6.10 |
| Buffalo | 8.01 | 7.32 | 9.72 | 10.00 | 11.27 | 10.53 | 8.65 | 7.60 |
| New York | 10.72 | 9.10 | 11.44 | 10.41 | 11.44 | 9.91 | 12.26 | 9.55 |
| New Jersey | 10.05 | 13.27 | 13.41 | 11.58 | 13.21 | 13.24 | 12.64 | 11.34 |
| Pennsylvania | 9.10 | 11.06 | 12.28 | 11.93 | 12.49 | 11.70 | 9.68 | 10.62 |
| Philadelphia | 9.80 | 8.46 | 10.11 | 9.19 | 9.21 | 9.78 | 9.84 | 7.48 |
| Pittsburgh | 8.38 | 8.44 | 10.97 | 8.83 | 11.94 | 9.40 | 8.73 | 8.60 |
| Delaware | 4.08 | 7.06 | 8.88 | 9.58 | 9.72 | 10.08 | 9.32 | 9.34 |
| Maryland | 6.63 | 9.92 | 12.00 | 9.94 | 11.72 | 10.93 | 11.60 | 10.99 |
| Baltimore | 4.66 | 9.83 | 10.01 | 8.84 | 8.96 | 7.98 | 8.81 | 5.89 |
| Washington, D. C. | 8.54 | 10.65 | 10.99 | 10.21 | 9.71 | 13.57 | 10.17 | 10.47 |
| Total Eastern States | 9.60 | 9.84 | 11.58 | 10.59 | 11.76 | 10.91 | 11.25 | 9.90 |
| Virginia | 7.47 | 9.19 | 8.06 | 7.15 | 7.13 | 7.39 | 5.13 | 7.62 |
| Richmond | 11.11 | 10.07 | 8.51 | 10.45 | 8.29 | 11.44 | 7.89 | 6.90 |
| West Virginia | 13.52 | 10.28 | 12.05 | 11.20 | 10.06 | 7.53 | 7.36 | 7.18 |
| North Carolina | 7.88 | 7.64 | 7.84 | 9.08 | 8.40 | 8.46 | 9.39 | 7.86 |
| Charlotte[14] | .... | .... | .... | .... | .... | .... | .... | 6.76 |
| South Carolina | 6.55 | 3.05 | 3.21 | 7.00 | *–2.09* | 2.47 | 4.72 | 7.54 |
| Charleston | 10.82 | 2.76 | .... | .... | .... | .... | .... | .... |
| Georgia[2] | 5.38 | 2.96 | 4.11 | 3.96 | 3.51 | 4.73 | 1.63 | 4.63 |
| Atlanta | 9.85 | 8.21 | 10.49 | 6.76 | .46 | 10.39 | 11.05 | 8.64 |
| Savannah | .... | 6.34 | .... | .... | .... | .... | 1.45 | .... |
| Florida | 13.93 | 8.60 | 11.94 | 13.36 | 20.36 | 25.22 | 6.62 | 3.63 |
| Jacksonville | 17.41 | 9.74 | 13.96 | 17.75 | 25.28 | 22.69 | 11.81 | 10.24 |
| Alabama | 6.20 | 7.41 | 8.38 | 8.24 | 7.59 | 10.03 | 7.51 | 9.97 |
| Birmingham | 13.79 | 14.79 | 23.45 | 17.18 | 17.24 | 14.91 | 13.36 | 12.47 |
| Mississippi | 3.95 | 7.45 | 7.48 | 7.93 | 9.04 | 10.21 | 8.59 | 8.76 |
| Louisiana[3] | 6.35 | *–5.05* | 5.14 | 3.22 | 7.85 | 9.46 | 7.15 | 6.58 |
| New Orleans | 18.98 | 9.23 | 11.98 | 10.85 | 9.71 | 10.96 | 11.26 | .... |
| Texas | 3.73 | *–0.48* | 2.33 | 5.04 | 5.90 | 7.53 | 5.00 | 7.08 |
| Dallas | 13.44 | 10.92 | 4.69 | 13.91 | 12.52 | 14.68 | 11.94 | 10.78 |
| El Paso | 11.45 | 8.41 | 4.44 | 2.45 | 7.97 | 10.77 | 5.68 | 6.04 |
| Fort Worth | .... | 5.01 | 3.41 | 6.21 | 5.31 | 11.01 | 12.38 | 10.71 |
| Galveston | 14.38 | 1.38 | 2.25 | 8.14 | 11.91 | 9.80 | 7.54 | 9.23 |
| Houston | 7.98 | 7.75 | 6.63 | 5.64 | 9.38 | 9.34 | 10.41 | 10.12 |
| San Antonio | 10.79 | 4.23 | 6.56 | 5.79 | 5.23 | 7.81 | 8.54 | 8.73 |
| Waco | 8.56 | 7.00 | 8.80 | 12.16 | 7.91 | 8.59 | 8.09 | 4.11 |

TABLE VI (*Continued*)

| Cities States Territories | Per Cent Net Additions To Profits To Capital and Surplus (–Italics Denote Deficit) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1921 | 1922 | 1923 | 1924 | 1925 | 1926 | 1927 | 1928 |
| Arkansas[4] | 8.11 | 6.91 | 8.14 | 9.13 | 6.47 | 7.35 | 7.54 | 7.02 |
| Little Rock | 8.95 | 10.35 | 6.74 | 7.01 | 6.70 | 6.40 | 4.40 | .... |
| Kentucky | 10.86 | 9.72 | 10.10 | 9.45 | 8.40 | 7.93 | 7.71 | 8.34 |
| Louisville | 14.22 | 9.89 | 16.06 | 14.70 | 17.35 | 11.25 | 14.91 | 10.06 |
| Tennessee[5] | 10.59 | 9.14 | 8.87 | 8.12 | 7.93 | 8.11 | 8.56 | 7.24 |
| Chattanooga | 9.44 | 8.60 | .... | .... | .... | .... | .... | .... |
| Memphis | 7.54 | 9.04 | 5.71 | 7.94 | 6.93 | 11.59 | *–17.06* | .... |
| Nashville | 7.77 | 14.90 | 16.78 | 8.49 | 10.39 | 9.49 | 8.87 | 6.86 |
| Total Southern States | 8.12 | 6.20 | 7.34 | 8.04 | 7.90 | 9.47 | 7.32 | 7.73 |
| Ohio[6] | 9.57 | 8.55 | 8.61 | 8.74 | 8.01 | 7.64 | 6.25 | 7.22 |
| Cincinnati | 9 07 | 10.30 | 10.02 | 9.07 | 11.70 | 9.75 | 13.27 | 11.82 |
| Cleveland | 12.94 | 12.44 | 6.45 | 7.14 | 9.30 | 8.71 | 9.49 | 6.03 |
| Columbus | 11.98 | 9.13 | 10.12 | 9.13 | 7.94 | 9.00 | 7.36 | 11.72 |
| Toledo | 5.98 | 7.97 | 10.57 | 11.29 | .93 | 15.13 | 13.80 | .... |
| Indiana | 10.39 | 8.60 | 9.55 | 7.77 | 7.80 | 8.40 | 8.59 | 8.18 |
| Indianapolis | 10.20 | 7.60 | *–18.93* | 9.59 | 20.82 | 9.83 | 11.20 | 7.11 |
| Illinois | 10.56 | 9.62 | 8.49 | 5.52 | 8.09 | 9.14 | 8.61 | 8.19 |
| Chicago (Cent. Res.) | 13.57 | 7.22 | 6.73 | 9.03 | 6.37 | 10.10 | 11.58 | 9.42 |
| Chicago (Other Res.) | 20.10 | 12.55 | 10.52 | 11.36 | 12.14 | 11.00 | 12.04 | 8.62 |
| Peoria | 14.21 | 8.47 | 9.44 | 7.68 | 9.07 | 9.06 | 9.18 | 10.03 |
| Michigan[7] | 10.72 | 11.75 | 10.36 | 8.83 | 9.92 | 11.30 | 11.28 | 10.76 |
| Detroit | 10.79 | 9.63 | 8.55 | 9.31 | 10.11 | 8.20 | 9.76 | 8.29 |
| Grand Rapids | 2.13 | 3.82 | 8.91 | 9.09 | 14.06 | 11.14 | 9.33 | .... |
| Wisconsin | 11.91 | 9.24 | 9.31 | 8.17 | 7.45 | 9.90 | 10.29 | 11.23 |
| Milwaukee | 20.19 | 7.87 | 6.46 | 8.21 | 4.02 | 10.03 | 10.54 | 8.80 |
| Minnesota | 10.60 | 5.82 | 3.90 | 3.74 | 2.68 | 5.36 | 5.16 | 5.24 |
| Minneapolis | 11.53 | 5.11 | *–1.23* | 2.80 | 7.74 | 8.80 | 8.17 | 9.62 |
| St. Paul | 9.82 | 12.34 | 9.89 | 5.95 | 7.91 | 15.57 | 13.20 | 18.45 |
| Iowa[8] | 9.98 | 3.14 | 3.92 | *–.53* | *–1.73* | *–.66* | *–1.75* | 1.81 |
| Cedar Rapids | 9.87 | 6.53 | 14.00 | 2.35 | 8.29 | 3.71 | 7.03 | .... |
| Des Moines | 11.08 | 10.41 | 6.31 | *–.64* | 5.95 | 1.56 | 1.49 | *–2.26* |
| Dubuque | 12.40 | 8.72 | 12.20 | 6.40 | 5.60 | 8.80 | 8.10 | .... |
| Sioux City | 4.18 | 7.81 | 3.27 | .63 | *–11.25* | 2.07 | 1.63 | *–17.66* |
| Missouri | 10.29 | 4.55 | 5.82 | 3.33 | 5.04 | 6.10 | 6.48 | 4.28 |
| Kansas City | 14.65 | 4.48 | *–1.23* | *–.82* | 3.52 | 9.96 | 9.07 | 10.25 |
| St. Joseph | 11.95 | 3.55 | 8.39 | *–3.85* | 6.44 | 7.46 | .34 | 8.24 |
| St. Louis | 10.97 | 7.26 | 7.30 | 7.22 | 9.87 | 8.90 | 6.73 | 10.95 |
| Total Mid-Western States | 11.29 | 7.93 | 6.75 | 6.82 | 7.23 | 8.50 | 8.50 | 8.47 |
| North Dakota | 8.13 | .74 | 1.27 | *–6.95* | *–2.20* | 1.19 | 2.29 | 2.77 |
| South Dakota | 4.90 | .... | 1.70 | *–2.43* | *–1.46* | .85 | 1.89 | 5.04 |
| Nebraska | 9.29 | 3.02 | 6.12 | .15 | 1.50 | .82 | 2.16 | 5.43 |
| Lincoln | 8.44 | 4.62 | 5.04 | 9.03 | 7.53 | 6.53 | 6.71 | 8.64 |
| Omaha | 7.96 | 4.26 | 1.56 | *–6.26* | 4.93 | 8.04 | 1.74 | 11.07 |
| Kansas[9] | 7.25 | 5.91 | 2.70 | 1.87 | 2.93 | 3.69 | 3.03 | 4.88 |
| Kansas City | 12.58 | 7.77 | 3.17 | *–1.62* | 2.95 | 5.54 | 2.76 | .... |
| Topeka | 12.28 | 10.92 | 8.30 | 9.69 | 2.85 | 8.88 | 10.19 | 12.58 |
| Wichita | 11.24 | 3.33 | 3.05 | 3.10 | 8.87 | 6.59 | 8.13 | 4.27 |
| Montana[10] | 3.63 | *–0.95* | *–2.67* | *–7.99* | *–.44* | 5.23 | 6.15 | 10.49 |
| Helena | 6.45 | 9.94 | *–4.77* | 8.52 | 2.58 | 5.29 | 10.97 | .... |
| Wyoming | 10.38 | 4.81 | 2.99 | .35 | *–5.92* | 5.70 | 8.66 | 8.83 |
| Colorado[11] | 6.87 | 2.51 | 1.49 | .94 | 2.62 | 1.79 | 4.64 | 4.22 |
| Denver | 5.81 | 8.00 | 9.30 | 16.06 | 8.89 | 9.05 | 10.74 | 13.19 |
| Pueblo | 19.24 | 1.75 | 14.83 | 4.74 | 12.86 | 7.26 | 6.34 | .... |

TABLE VI (*Continued*)

| Cities States Territories | Per Cent Net Additions To Profits To Capital and Surplus (–Italics Denote Deficit) | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1921 | 1922 | 1923 | 1924 | 1925 | 1926 | 1927 | 1928 |
| New Mexico | 4.52 | 2.05 | *–6.55* | *–4.11* | *–3.22* | 1.72 | 5.77 | 8.58 |
| Oklahoma | 4.46 | *–1.45* | *–1.22* | *–1.96* | 2.17 | 3.15 | 3.95 | 8.55 |
| Muskogee | 13.23 | 5.74 | 7.18 | 2.73 | 9.08 | 8.51 | 15.72 | 15.98 |
| Oklahoma City | 4.21 | 5.03 | 8.25 | 4.35 | 11.10 | 7.55 | 7.69 | 16.47 |
| Tulsa | 12.69 | 3.84 | 1.94 | *–8.44* | .78 | 11.21 | 14.80 | 13.43 |
| Total Western States | 7.14 | 2.39 | 2.23 | *–.19* | 2.69 | 4.41 | 5.41 | 8.07 |
| Washington | 10.74 | 4.87 | 5.70 | 1.96 | 7.98 | 10.69 | 8.28 | 11.95 |
| Seattle | 10.90 | 9.28 | 13.41 | 11.60 | 15.14 | 15.17 | 14.69 | 22.15 |
| Spokane | 8.28 | 11.47 | 3.09 | 2.09 | 8.02 | .70 | 2.18 | 5.83 |
| Tacoma | 15.04 | *–5.44* | 4.54 | .... | .... | .... | .... | .... |
| Oregon | 7.46 | 2.20 | 1.93 | 5.02 | 6.09 | 6.25 | 5.10 | 6.97 |
| Portland | 9.70 | 5.77 | *–0.15* | 7.84 | 6.64 | 10.51 | 14.85 | 11.64 |
| California[12] | 9.14 | 9.99 | 8.79 | 7.93 | 7.39 | 7.24 | 6.45 | 8.32 |
| Los Angeles | 13.00 | 15.01 | 13.45 | 11.64 | 10.80 | 11.54 | 10.58 | 7.06 |
| Oakland | 11.44 | 4.04 | 5.36 | 9.41 | 8.69 | 11.76 | 5.28 | .... |
| San Francisco | 8.83 | 3.04 | 5.32 | 8.23 | 7.36 | 7.46 | 9.04 | 6.79 |
| Idaho | 3.35 | *–4.35* | *–3.71* | *–1.43* | *–4.43* | 1.20 | 1.67 | 8.02 |
| Utah[13] | 6.16 | 7.46 | 3.77 | 2.69 | 3.72 | 6.75 | 4.49 | 5.36 |
| Ogden | .... | 7.53 | *–2.40* | 3.73 | 8.36 | *–11.11* | 4.78 | .... |
| Salt Lake City | 3.77 | *–0.11* | 1.06 | *–14.48* | 7.44 | 10.32 | 8.90 | 8.24 |
| Nevada | 12.36 | 11.51 | 3.05 | 6.45 | 6.50 | 10.76 | 5.00 | 3.69 |
| Arizona | .... | *–7.04* | *–6.42* | *–4.55* | *–6.31* | *–10.76* | *–13.02* | 2.45 |
| Total Pacific States | 8.86 | 5.98 | 6.05 | 6.86 | 7.68 | 8.39 | 8.40 | 7.99 |
| Alaska (Non-Member) | 14.29 | 5.65 | 16.09 | 20.43 | 15.31 | 22.26 | 24.78 | 18.84 |
| Hawaii (Non-Member) | 14.59 | 9.23 | 11.35 | 11.54 | 10.76 | 11.60 | 12.12 | 10.84 |
| Total Non-Members | 14.55 | 8.58 | 12.16 | 13.02 | 11.72 | 13.74 | 14.68 | 12.69 |
| Total United States | 9.40 | 7.79 | 8.48 | 8.11 | 9.00 | 9.54 | 9.24 | 8.96 |

[1] Includes two banks in Reserve City of Albany in 1928.
[2] Includes one bank in Reserve City of Savannah in 1928.
[3] Includes one bank in Reserve City of New Orleans in 1928.
[4] Includes one bank in Reserve City of Little Rock in 1928.
[5] Includes one bank in Reserve City of Memphis in 1928.
[6] Includes one bank in Reserve City of Toledo in 1928.
[7] Includes two banks in Reserve City of Grand Rapids in 1928.
[8] Includes two banks in each Reserve City of Cedar Rapids & Dubuque in 1928.
[9] Includes two banks in Reserve City of Kansas City in 1928.
[10] Includes two banks in Reserve City of Helena in 1928.
[11] Includes two banks in Reserve City of Pueblo in 1928.
[12] Includes two banks in Reserve City of Oakland in 1928.
[13] Includes two banks in Reserve City of Ogden in 1928.
[14] Made a Reserve City in 1928.

NOTE: Where figures for cities are shown in any one state, the state figures represent averages of banks in that state outside of these cities.

This table is used with the kind permission of the H. N. Stronck Co., Consultants, who calculated and prepared it.

past. Thus Montana, Utah, Idaho, New Mexico, South Dakota, and South Carolina had losses or conspicuously low earnings during the past eight years for their national banks.

The same states that led the nation in bank suspensions are exhibiting additional weaknesses as shown by the earnings statements. The survey includes only national banks and does not include the much larger and financially, no doubt, weaker state systems. Figures for earnings of state banks have not been made available to the author. Some idea of their earning position relative to the strength of national banks can be glimpsed when we again review suspensions of banks. Between 1921 and 1927 inclusive 8 per cent of the national banks suspended, but 14.4 of the state banks that were members of the Federal Reserve System suspended and 17.8 per cent of the state banks that were non-members. Among the larger number of state banks the suspension rate was more than twice that of the national banks. It is to be presumed, therefore, that the earnings of the state banks, when made available, will probably make a much weaker showing than has been given for the national banks.

When it is thus possible to isolate weaknesses of the American banking system to the small bank in the smaller communities, particularly in the agricultural regions, we have good cause to associate with the banking weakness two economic conditions: (1) the flight of profitable banking business from the small town, and (2) the depression of agriculture.

Fundamentally these are the causes responsible

for bank suspensions during the past eight years. The present conglomerate banking structure as existing in the regions of distress has been unable to adjust itself to the changing economic conditions. It is not improbable that other causes contributed. The statistical division of the Federal Reserve Board, speaking of the bank failure, says:

"The principal cause of bank suspension during the seven year period was reported as the accumulation of a large proportion of worthless, slow or past due paper, but in quite a number of places poor and heavy withdrawals were assigned as largely responsible for the suspensions. The causes of suspensions listed in the order of importance, i.e. based on the number of times as having been a primary or contributory cause, are as follows: first, doubtful, slow or past due paper; second, heavy withdrawals; third, poor management; fourth, depreciation of security; fifth, loans to officers and directors; sixth, defalcation; seventh, loans to enterprises in which officers and directors were interested; eighth, failure of bank correspondent; ninth, failure of other large debtors."

While it is probably true that all of these causes for suspension were important, yet the question may legitimately be raised whether these are causes or effects, effects of much more fundamental economic tendencies. The causes listed by the Statistical Division should operate to make bank suspension uniform in all classes of banks throughout the United States. Assuming average managerial ability, poor management probably is also present in large cities even though not as common as in small towns. Managerial ability is not neces-

sarily a geographic phenomenon and cannot be said to be perfect in Delaware and only half perfect in Iowa. The statement of the Federal Reserve Board overlooks the fact that certain fundamental conditions were operative in the banks of Iowa that were not operative in the banks of Delaware. The Statistical Division summarizes the nine causes for suspension as all being traceable to a lack of sound bank management. True. But we venture the assertion that in face of an unparalleled agricultural depression in Iowa, Minnesota, North Dakota and South Dakota and in face of the inroads in the towns' business by central corporations, with all due credit to the perfect record made by bankers in Delaware, they also would have been confronted with failures probably of as great proportions as the present bankers of Iowa had they charge of the banks in these regions. We must admit that a changing economic condition has placed the unit banks in an impossible position and that in part an archaic banking system, not geared up to modern business needs, is responsible for the banking debacle.

Nor is the position of the small country bank made easier by the fact that apparently there are too many banks for the population. Thus in North Dakota there were in 1919, 10.69 banks for each 10,000 population (see Tables VII and VIII). The rate of suspensions was 39.6 per cent of its banks during the next ten years. South Dakota had 8.45 banks for each 10,000 population of which 53.9 per cent were suspended in the last eight years. Montana had 8.36 banks per 10,000 population and sus-

## TABLE VII

### Comparison of Number of Banks per 10,000 of Population by States

Contrasting Periods: June 30, 1919—March 27, 1929

| State | June 30, 1919 | | | | | March 27, 1929 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Population (000 Omitted) | Number of Banks | | | No. Per 10,000 Population | Population (000 Omitted) | Number of Banks | | | No. Per 10,000 Population |
| | | Natl. | State | Total | | | Natl. | State | Total | |
| Alabama | 2,385 | 94 | 261 | 355 | 1.49 | 2,530 | 107 | 250 | 357 | 1.41 |
| Arizona | 350 | 18 | 63 | 81 | 2.13 | 439 | 15 | 31 | 46 | 1.05 |
| Arkansas | 1,830 | 78 | 386 | 464 | 2.54 | 1,895 | 77 | 349 | 426 | 2.25 |
| California | 3,330 | 279 | 425 | 704 | 2.11 | 4,465 | 208 | 247 | 355 | 1.02 |
| Colorado | 1,080 | 127 | 244 | 371 | 3.44 | 1,065 | 122 | 168 | 290 | 2.72 |
| Connecticut | 1,330 | 67 | 150 | 217 | 1.63 | 1,625 | 65 | 187 | 252 | 1.55 |
| Delaware | 225 | 19 | 26 | 45 | 2.00 | 245 | 18 | 42 | 60 | 2.45 |
| District of Columbia | 480 | 14 | 30 | 44 | .91 | 530 | 12 | 29 | 41 | .77 |
| Florida | 955 | 53 | 200 | 253 | 2.65 | 1,310 | 60 | 203 | 263 | 2.05 |
| Georgia | 2,895 | 95 | 653 | 748 | 2.53 | 3,130 | 80 | 346 | 426 | 1.36 |
| Idaho | 510 | 70 | 138 | 208 | 4.08 | 520 | 43 | 95 | 138 | 2.65 |
| Illinois | 6,330 | 471 | 1,079 | 1,550 | 2.43 | 7,260 | 487 | 1,315 | 1,802 | 2.48 |
| Indiana | 2,900 | 253 | 781 | 1,034 | 3.57 | 3,155 | 222 | 781 | 1,003 | 3.18 |
| Iowa | 2,250 | 356 | 1,502 | 1,856 | 8.26 | 2,530 | 265 | 1,024 | 1,289 | 5.09 |
| Kansas | 2,000 | 241 | 1,084 | 1,325 | 6.63 | 1,842 | 247 | 840 | 1,087 | 5.90 |
| Kentucky | 2,460 | 129 | 446 | 575 | 2.34 | 2,530 | 139 | 439 | 578 | 2.28 |
| Louisiana | 1,675 | 32 | 222 | 254 | 1.35 | 1,930 | 33 | 192 | 225 | 1.17 |
| Maine | 783 | 62 | 97 | 159 | 2.03 | 787 | 54 | 80 | 134 | 1.70 |
| Maryland | 1,435 | 96 | 155 | 251 | 1.75 | 1,625 | 82 | 154 | 236 | 1.45 |
| Massachusetts | 3,940 | 158 | 300 | 458 | 1.16 | 4,230 | 154 | 525 | 679 | 1.61 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Michigan | 3,200 | 108 | 595 | 703 | 2.20 | 4,425 | 134 | 613 | 747 | 1.69 |
| Minnesota | 2,390 | 305 | 1,148 | 1,453 | 6.03 | 2,675 | 275 | 814 | 1,089 | 4.07 |
| Mississippi | 2,010 | 33 | 293 | 326 | 1.62 | 1,793 | 36 | 302 | 333 | 1.89 |
| Missouri | 3,520 | 133 | 1,413 | 1,546 | 4.39 | 3,478 | 134 | 1,191 | 1,325 | 3.81 |
| Montana | 500 | 134 | 284 | 418 | 8.36 | 700 | 69 | 128 | 197 | 2.81 |
| Nebraska | 1,375 | 189 | 957 | 1,146 | 8.33 | 1,338 | 156 | 711 | 867 | 6.25 |
| Nevada | 126 | 10 | 23 | 33 | 2.62 | 79 | 10 | 25 | 35 | 4.43 |
| New Hampshire | 453 | 55 | 70 | 125 | 2.76 | 457 | 56 | 68 | 124 | 2.71 |
| New Jersey | 3,095 | 203 | 171 | 374 | 1.21 | 3,850 | 298 | 272 | 570 | 1.48 |
| New Mexico | 470 | 44 | 69 | 113 | 2.40 | 395 | 28 | 30 | 58 | 1.47 |
| New York | 10,713 | 480 | 541 | 1,021 | .95 | 11,650 | 565 | 577 | 1,142 | .98 |
| North Carolina | 2,520 | 82 | 471 | 553 | 2.19 | 2,930 | 74 | 428 | 502 | 1.71 |
| North Dakota | 825 | 172 | 710 | 882 | 10.69 | 6,688 | 131 | 337 | 468 | 7.01 |
| Ohio | 5,335 | 369 | 781 | 1,150 | 2.16 | 6,563 | 325 | 709 | 1,034 | 1.58 |
| Oklahoma | 2,515 | 343 | 582 | 925 | 3.68 | 2,372 | 315 | 339 | 654 | 2.76 |
| Oregon | 925 | 87 | 178 | 265 | 2.86 | 875 | 92 | 144 | 236 | 2.70 |
| Pennsylvania | 8,930 | 834 | 643 | 1,477 | 1.65 | 9,650 | 860 | 982 | 1,842 | 1.91 |
| Rhode Island | 645 | 17 | 31 | 48 | .74 | 685 | 10 | 23 | 33 | .48 |
| South Carolina | 1,650 | 79 | 342 | 421 | 2.55 | 1,840 | 53 | 211 | 264 | 1.43 |
| South Dakota | 775 | 126 | 529 | 655 | 8.45 | 696 | 95 | 307 | 402 | 5.78 |
| Tennessee | 2,335 | 103 | 416 | 519 | 2.22 | 2,470 | 101 | 391 | 492 | 1.99 |
| Texas | 4,650 | 543 | 945 | 1,488 | 3.20 | 5,310 | 623 | 709 | 1,332 | 2.51 |
| Utah | 465 | 26 | 99 | 125 | 2.69 | 518 | 20 | 85 | 105 | 2.03 |
| Vermont | 370 | 48 | 58 | 106 | 2.86 | 356 | 46 | 59 | 105 | 2.95 |
| Virginia | 2,275 | 153 | 295 | 448 | 1.97 | 2,520 | 165 | 322 | 487 | 1.93 |
| Washington | 1,740 | 83 | 281 | 364 | 2.09 | 1,555 | 108 | 237 | 345 | 2.22 |
| West Virginia | 1,450 | 119 | 214 | 333 | 2.30 | 1,650 | 119 | 201 | 320 | 1.94 |
| Wisconsin | 2,650 | 147 | 798 | 945 | 3.57 | 2,940 | 156 | 807 | 963 | 3.28 |
| Wyoming | 200 | 42 | 106 | 148 | 7.40 | 233 | 25 | 62 | 87 | 3.73 |
| Porto Rico | 1,265 | | 13 | 13 | .10 | 1,385 | | | | |
| Alaska | 94 | 3 | 13 | 16 | 1.70 | 91 | 4 | | 4 | .44 |
| Hawaii | 235 | 3 | 17 | 20 | .85 | 310 | 2 | | 2 | .06 |
| Philippines | 9,250 | | 10 | 10 | .01 | 11,170 | | | | |
| Total | 118,444 | 7,785 | 21,338 | 29,123 | 2.46 | 131,320 | 7,575 | 18,386 | 25,961 | 1.98 |

## TABLE VIII

### Comparison of Number of Banks Per 10,000 of Population

Since it has been said that one of the prime causes of bank suspensions is "too many banks," a table is presented on a following page, which indicates the number of banks per 10,000 population in each state and contrasts this position between the time points June 30, 1919, and March 27, 1929.

It will be observed that at June 30, 1919, the following states had an exceptionally high ratio:

| *State* | *Number of Banks per 10,000 of Population* | *Suspension Ratio* |
|---|---|---|
| North Dakota | 10.69 | 39.6% |
| South Dakota | 8.45 | 53.9 |
| Montana | 8.36 | 46.6 |
| Nebraska | 8.33 | |
| Iowa | 8.26 | 25.1 |
| Wyoming | 7.40 | 36.9 |
| Kansas | 6.63 | 13.7 |
| Minnesota | 6.08 | 22.0 |
| Missouri | 4.39 | 14.6 |
| Idaho | 4.08 | 30.2 |

It will be seen that there is some degree of correlation between the population and the suspension ratios. It also correlates with the bank suspension ratios by size of capital and size of communities, for it is within these states that we find a large proportion of small communities and a large proportion of small banks.

It will be observed that a considerable improvement in the population ratio is indicated at March 27, 1929.

### Trend of Resources and Number of State and National Banks—(1870–1929)

(See chart 5)

It will be observed that the total resources of state banks during the 54-year period—1875-1929—increased from approximately $1,291,427,000 to $43,804,599,000; an increase of 3,292 per cent.

During the same period, national bank resources increased from $1,913,239,000 to $29,021,912,000; an increase of 1,417 per cent.

During the same 54-year period (1875–1929) the *number* of state

banks increased from 1,260 to 18,386; an increase of 1,359 per cent. The national banks increased in number from 2,076 to 7,575; an increase of 265 per cent.

The "high peak" in *number* of banks was 1920 with 22,109 state and 8,030 national banks. From 1920 to 1929 the number of state banks decreased 3,723 and the number of nationals 495.

The trend since 1920 is strongly towards *greater resources* and a *lesser number* of banks.

RESOURCES OF STATE AND NATIONAL BANKS IN DOLLARS AND BY PERCENTAGES

By years—1919–1929

(See chart 4)

It will be observed that state banks indicated *increases* in total resources each year with the exception of a small decline in 1921 from 1920, a decline of but $514,327. National bank resources reflected a far more abrupt decline in 1920 from 1921, losing $2,893,391,000.

The relationship between the trend of position of state and national resources is shown on the lower chart. In 1919 the state bank resources comprised 55.41 per cent of the total and the nationals 44.59 per cent. On March 27, 1929, the state banks represented 60.15 per cent of the total and nationals but 39.85 per cent.

It is apparent, therefore, that in this increase of total resources of all banks, *the nationals are obtaining far less of this proportionate increase than the state banks.*

(NOTE: at June 27, 1929, total resources of all nationals *declined* to $27,440,228,000, a *decline* of $1,581,684,000 from March 27, 1929. This loss was accompanied by a loss of but 39 banks.)

pended 46.6 per cent. Obviously when there is one bank for each 1,182 population, there is a plethora of banking service. England, with a dozen banks and more than 8,000 branch banks, has one bank office to every 4,717 population.

It can be shown that there is a definite relation between these suspensions and the excessive number of banks relative to population. In the last eight years the situation has improved a great deal

throughout the United States. Including suspensions and mergers, the number of banks in the United States per 10,000 population was reduced from 2.46 in 1919 to 1.98 in 1929, a reduction of 24 per cent. There is still much liquidation to be done. North Dakota still has 7.01 banks per 10,000 population; South Dakota, 5.78; Kansas, 5.90; Iowa, 5.09; Nebraska, 6.25. It may be pointed out here that Delaware, with no suspensions, had 2.0 banks per 10,000 population in 1919 and in 1928 still had 2.45 banks per 10,000 population. Vermont had 2.86 banks in 1916 and in 1929 had 2.89 banks. The District of Columbia, also with no suspensions, had .91 and today has .77. New York had .95 banks and today has .98.

To some extent the larger cities suffered with many of the smaller towns from an excessive number of banks, many of them too small to give adequate service to the growing industrial needs of the country and, because excessive in numbers, disastrously competing with each other, many of them located in dwindling communities and on the whole contributing to a frail system that has in it the germs of its own destruction.

Summed up, the banking system in the small towns of America is today in a critical condition in consequence of the fundamental changing production and distribution developments, the semi-bankrupt state of agriculture and because the number of banks in the country is far in excess of the banking service required. Also many of these small banks are in the hands of incompetent leaders. The result has been widespread failure of banks, undermined

confidence in their security and a growing number having no economic reason for existence—banks that are unprofitable. But critical as is their condition, unsound as is their management, the personnel in charge of this large array of small banks, by sheer weight of numbers, is much more audible in the political centers of the nation than are those who demand a sounder banking system. These small banks, many of them financial failures, are manned by men who are of consequence in the community. In fact, their eminence in the community is because of their association with the banks. These men refuse to immolate themselves on the altars of profits or progress. They resist the introduction of branch banks because it means their annihilation. In this case the banker is not the mythical economic man, but he reacts emotionally. He is sentimentally associated with the bank through pride, ancestry or social status, and though he sees it crumble, though he notes the inferior demand for its services and the waning confidence in him and in his institution, he still protests against the annihilation of the now gilded system in which he has once played a glorious part.

## CHAPTER IV

### The Development of Chain Banking

AN AMAZING development in concentration of control over the unit bank has taken place in the past few years, a development that has come to be called group or chain banking. It is frequently insisted that the two are not synonymous and represent different modes of bank concentration. We shall come to discuss these differences later.

It is a growth wholly different from the European system of branch banking. Branch banking is popularly understood to mean the setting up of a branch or office of an existing bank, in a locality other than that of the parent bank. Such offices of central banks as exist in the same cities are not considered strictly branch banks, since they do not violate the principle of the unit bank. The office is merely a convenient depository for clients at some distance from the parent bank. The parent bank with its offices is a self-contained unit managed and financed under the control of a board of directors. At present member banks of the Federal Reserve System are not permitted to open branches beyond the city limits of the parent bank, even in states where the state laws permit the state banks to do so. City branch banking is not permitted to the members of the Federal System when located in states

that do not permit their own banks a like privilege. But city branch banking is not regarded as branch banking in the full sense of the word.

The controversy about branch banking centers on the question of permitting a parent central institution to open a branch or an office in a different town or city, the limits of such extension of banking operations being either the state, the Reserve District or the nation. A branch bank is an integral part of the parent institution. It has a manager in charge and its assets and liabilities are merged with the parent institution. It can give to the client in the small town the same service as to the client of the large central city; its deposits may be used as directed from central managing offices and its investments are merged with the parent bank. It is nothing more than an office of the central bank for convenience of clients of that bank in that city. It has no separate board of directors or separate group of officers nor will it issue a separate statement nor have assets or debts that can be distinguished from the parent bank. It is as much a part of the central institution as the local station of a railroad.

The chain or group system is usually formed by an individual or a holding company who acquire the majority of stock of a number of unit banks and then set up a central management personnel for the purpose of operating the group as nearly as possible as a single system. The local board of directors is retained as are its local officers; in fact, the bank is in law a unit bank. Acquisition of stock becomes easier for the holding company when the

local management is assured that they will remain in nominal control, that no officers will lose their positions, that the name of the bank or its operation will remain as before. All this in fact being true at least until the next annual election. It can readily be seen how much more captivating this argument is to the local bank stockholders, who usually are also officers and directors, than would be the reorganization of the bank into a branch bank that would deprive them of their perquisites. The stockholder who may be either losing money on his bank stock or not making an adequate dividend is asked to sell to, or exchange his stock for stock in, the holding company and is given to understand that his position and in fact the individuality of the bank in which he may have a sentimental interest, will remain in status quo. Profits are to be secured by better management, by superior advice and counsel given from the central organization of the holding company to be set up; by a better use of reserve and deposit funds and by superior investment opportunities through more central contacts. The transition from a local unit to a member of the chain banking system is thus eased. There is no doubt, if branch banking were permitted, that acquiring control over banks for the purpose of converting them into branch banks would be much more difficult and probably much more expensive than is the unification by means of the chain system.

From the standpoint of the holding company, the scheme has advantages because of the ease of acquisition. Managing the bank subsequently

through an annually elected board of directors is cumbersome, time consuming and wasteful. Overhead gains are small, since a full corps of officers must be retained and the maintenance of the bank's individuality makes the introduction of uniform and readily controlled methods more difficult. It would seem, therefore, that the chain or group banking systems now being created would readily be converted into branch banking groups, once permissive legislation to that effect was passed by Congress.

A survey made by the Economic Policy Commission of the American Bankers' Association reveals three types of chain banks: (1) those that are dominated by more important banks; (2) those that are dominated by a non-banking holding company not subsidiary to any bank, and (3) where the dominant control is exercised by one individual or a group of individuals.

In the first group, those dominated by a particular bank, 78 instances were found involving 407 banks and representing resources of $6,473,000. The method of exercising control varies. While national banks are not permitted to own directly any stock in industrial corporations, or in other banks, this is not true in many of the state banks, and we therefore frequently find banking control exercised by the direct ownership of stock by a state bank or trust company enabling it to dictate the administration. Then again this ownership of a dominant bank may be exercised by the ownership by the directorate of stock in the subsidiary bank or banks. Frequently also the stock of a subsidiary bank is trusteed with the dominant bank. Again, there may

be a holding company in which the directorate of the dominant bank are the majority share holders and thus dominate the policies of a number of subsidiary banks. The well-known device of interlocking directorates, officers or a group of officers is also resorted to. There are other instances of varying details of these types.

The second group of chain banks is one that is dominated by a non-banking holding company which in itself is not a subsidiary to any particular bank, but which operates the whole chain or group for banking purposes in unison. Of these banks 28 instances, involving 380 banks, were found which had banking resources of $5,335,000,000. Again, this type of bank control varies. The holding company may be created by cash subscriptions, to a part of which, at least, the public is permitted to subscribe in an open market. Again, the holding company may have been formed by exchanging the stock of the holding company for the majority stock of the various banks within the group. There have also been found controlling but not managing holding companies, such as Investment Trusts or Insurance Companies, or other investment corporations, that utilize this means for investing funds.

The third group, the one in which the dominant control is exercised by one individual or a group of individuals showed 167 instances in existence controlling 1,071 banks with $1,467,720,000 in resources. They may be divided into the following types: (1) Those headed by a practical banker, who has acquired control of a number of banks, who personally directs and impresses his banking methods and

ideals on them through his individual contacts rather than through any definitely organized system or control. Such types are found mostly in the small communities and are probably more numerous in Minnesota than elsewhere. (2) Those in which the dominant head with the increase in his multiple banking interests sets a special directing supervisor, stationed probably in his principal bank, and systematically controls the members of his group. (3) Those in which the centralized management and bookkeeping unit with standard method in detail is set up by the dominant individual and all members of the group are required to refer loans and policies to this unit.

In so far as these chains are operated by banking groups, corporate or individual, strictly for banking purposes, little can be said about this form of bank unification as a dangerous financial structure. It is only when these bank chains can be manipulated by non-banking groups for non-banking purposes that the danger arises. It is for that reason that within the field there has been drawn a distinction between what is called chain banking and group banking. The term "group banking" is used to indicate a group of banks held together by a holding company which itself is incorporated, whereas a "chain bank" is a group of banks held together by an individual or a group of individuals.

It is claimed that group banking differs from chain banking in that the group bank, being an incorporated organization selling its stock on the open market, is strictly in the banking business; is desirous of promoting the financial interests of each;

will supplement the examinations of the bank by state and federal examiners with those of its own; will have no ulterior investment policies and in every way will endeavor to promote the banking interests of the community. Chain banks, on the other hand, being in the hands of one individual or a small group of individuals, whose operations need not be public, who may use the banks to promote enterprises in which he is interested, who may make heavy loans that are not strictly liquid banking loans, who may so juggle paper from one bank to another so as to impede examinations and who in fact may be in the banking business for purposes other than the promotion of the banks. Since 57 per cent of the chain banks in existence are in this latter class, though constituting only 11 per cent of chain bank assets, these differences are important if true.

The distinction between the two is, of course, only one of intent, and non-banking motives are not necessarily confined to chains privately owned. On the other hand, privately owned chains may most scrupulously observe the best banking methods. The Comptroller of the Currency, Mr. Pole, points out a weakness in the system which he regards as applicable to either so-called group or chain banks. He says:

"There appear to be . . . certain inherent weaknesses in the system of group banking. From an operative standpoint it is necessarily unwieldy. Each member of the group is a separate distinct corporation responsible to its own board of directors. It must operate as a separate corporation under its own capital and resources and under the distinct limitations placed upon its activi-

ties by law. The central management can enforce its policies only by indirection, that is to say, by inducing the local boards to accept voluntarily its policies and in case of refusal to set up at the next annual election a new board through its control over a majority of the stock. It is necessary to carry a full complement of overhead of personnel for each bank. . . . The corporate set up therefore of a group system is necessarily complicated, whereas under a system of branches, each branch is the bank itself and the full power and resources of the bank is in each place where it does business whether at the head office or at the branches."

As already indicated, partly in response to the weakened condition of the country banks, and partly in response to new economic conditions, an astounding development of chain or group banking has taken place. According to the report made in October, 1929, to the American Bankers' Association, there were at that time 273 chains in existence operating a total of 1,858 banks with resources of 13.3 billion dollars. The resources of these banks constitute more than one-sixth of the resources in all the banks in the United States. In other words, from the standpoint of resources the system of unit banks in the United States faces new and aggressive alignments. Whether branch banking is permitted or not, chain banking already is a sort of branch banking or rather it is a scheme to evade the national law, and to promote back door branch banking. In essence it may be said that chain banking is a bootleg method of branch banking and has in it at least one dangerous element, that of setting up under chain bank-

ing a new system of banking outside of either the state system or the federal system.

At present we have a National Bank Act under which banks organized under its provisions must submit to supervision from federal authorities. Then we have the Federal Reserve System which all national banks are compelled to join and which many state banks have found expedient to join. Morever, we have 48 states, practically every one of which has an independent banking statute of its own under which the so-called state banks are established. Finally, we have private banking houses which in many cases do not take deposits but nevertheless exercise other important banking functions.

Now comes the so-called holding company, building itself up in chain banking and group banking systems, and endeavoring to introduce still another kind of bank organization based upon joint control of a large number of institutions. These holding companies are not subject to any supervision or control. As they grow in influence and in power they form a veritable threat against any of the state banking systems and also against the national banking system.

The national banking system, as will be shown, has for a long time had to maintain itself in the face of severe competition from state banks and against the disrupting elements which come from the fact that so great a variety and confusion of legislation has existed. The federal government has not seen fit, although often urged to do so, to interfere in any way with the rapid development of the state system of banking in opposition to it. Two-thirds

of the banks in the United States are state banks and not allied with the Federal Reserve System. Is there anything now to prevent the rise of a new banking system more flexible to the needs of an aggressive business community to threaten the federal system? Under the state banking system the state banks have been confined to the limits of the states in which they were established, and when permitting branch banking, have had no branches outside the state. There may have been some sub rosa affiliations through joint directorates or surreptitious stock control which legislators have seen fit usually to overlook, but in the main the systems were limited by state boundaries. The holding company system now promises to bring about nation-wide, or at least section-wide grouping of banks that will far transcend state lines. Hitherto the national system has been confronted by no other system of national scope. It must now face one built up on an artificial and perhaps only halfway legal foundation, which however has a great deal of inherent strength. Bearing in mind that this new system will include a great many national banks which are far more anxious to advance their own interest and those of the banks affiliated with them than they are to develop the interests of national banks as such, the question may well be raised whether there is not a great deal in the development of chain banking to disturb those interested in the Federal Reserve System.

This competition is real. During the 54-year period between 1875 and 1929, state bank resources increased from approximately $1,291,427,000 to

A COMPARISON OF THE

# RESOURCES & NUMBER

## OF STATE & NATIONAL BANKS

AT VARIOUS INTERVALS FOR THE PERIOD 1870 TO 1929
ENDED JUNE 30

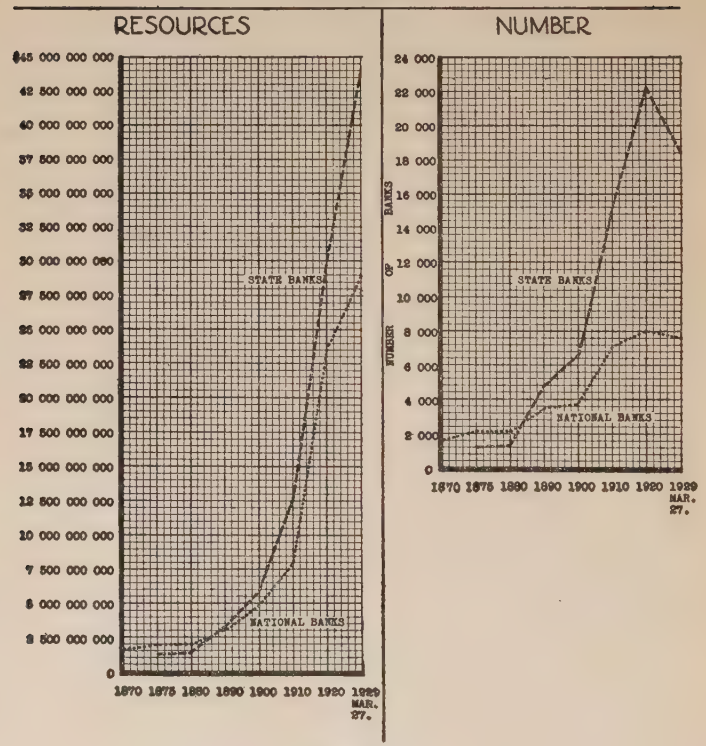



CHART IV.

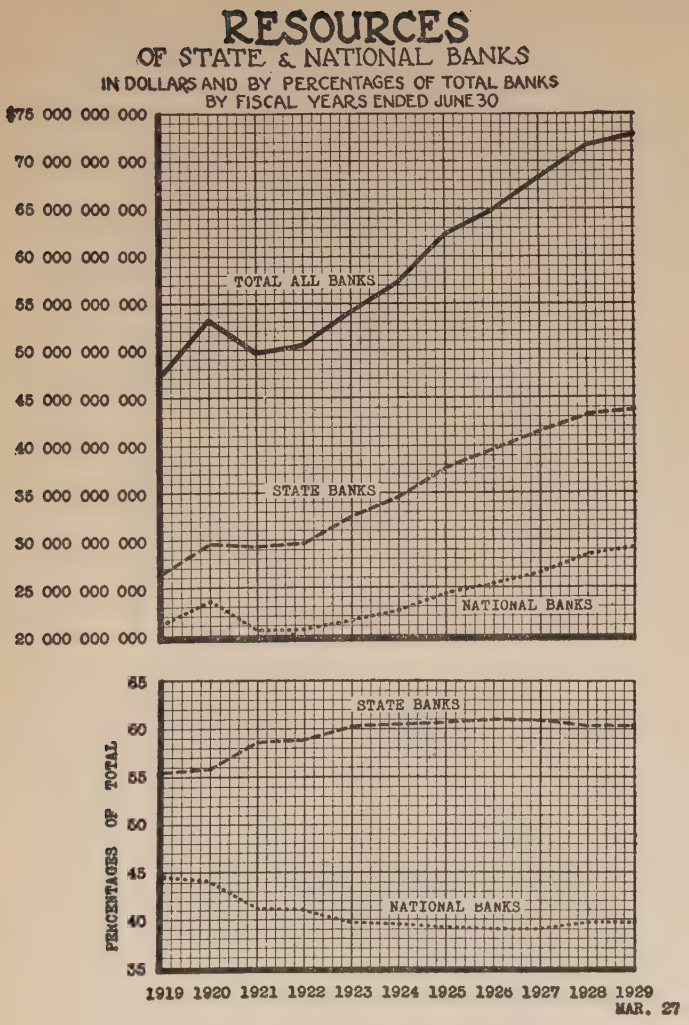

RESOURCES
OF STATE & NATIONAL BANKS
IN DOLLARS AND BY PERCENTAGES OF TOTAL BANKS
BY FISCAL YEARS ENDED JUNE 30
$75 000 000 000
70 000 000 000
65 000 000 000
60 000 000 000
55 000 000 000
50 000 000 000
45 000 000 000
40 000 000 000
35 000 000 000
30 000 000 000
25 000 000 000
20 000 000 000
TOTAL ALL BANKS
STATE BANKS
NATIONAL BANKS
PERCENTAGES OF TOTAL
65
60
55
50
45
40
35
STATE BANKS
NATIONAL BANKS
1919 1920 1921 1922 1923 1924 1925 1926 1927 1928 1929
MAR. 27

CHART V.

$43,804,599,000, and increase of 3,292 per cent (see Chart IV). During the same period national bank resources increased from $1,913,230,000 to $29,021,-912,000, an increase of only 1,417 per cent; the state bank resources increased 2.4 times as rapidly as those of the national banks. From 1920 to 1929 the resources of the state banks increased steadily with the exception of a small decline of $514,327 in 1921, whereas the national banks during that period showed losses in resources of $2,893,391,000. In 1919 the state bank resources comprised 55.41 per cent of the total and the national banks 44.59 per cent; but in March, 1929, the state banks represented 60.15 per cent and the national 39.85 per cent of the total bank resources (see Chart V). It is apparent, therefore, that in the increases during the period up to 1920, the national banks were obtaining less of their proportionate share than the state banks, and the figures clearly indicated the losing rôle played by national banks in the banking world after 1920. On June 29, 1929, the total of all national bank resources had declined to $27,440,228,-000, a decline in six months of $1,581,684,000; the loss in resources being accompanied by a loss to the system of 39 banks. From a peak, in 1921, of 30,812 banks, of which 8,154 were national and 22,658 were state banks, the number of banks declined to 25,961 on March 27, 1929, a loss of 4,861, or 15.8 per cent. The decline in percentage to number of state banks has been more rapid than for national banks up to 1928. The number of state banks declined 4,136 from 1921 to 1928, a loss of 18.2 per cent; and the number of national banks declined 558 from their

peak in 1922, a loss of but 6.8 per cent. But the loss rate from June 30, 1928, to March 27, 1929, was 1.51 per cent for national banks and only .73 per cent for state banks. In other words, commencing with 1928 the loss rate in number of national banks was more than double that for the state banks. Since the passage of the McFadden Act, the important object of which was to grant rights to the national banks so that they could better compete with state banks, there has been an additional decline in national banks more rapid than state banks though the trend in resources was upward until April, 1929, but the upward trend in resources was not as strong as for state banks and in the latter half of 1929 the tendency of resources has been downward. As a matter of fact, there has been a wave of secession from the national banks, banks that have converted their charters into state banks. The number of national banks that changed over to state banks between February 25, 1927, and July 6, 1929, was 263, distributed in 41 different states in which California leads with 65 national banks changing to state banks (see Table IX). In this connection it should be remembered that California permits state-wide branch banking. The total assets of the national banks which were succeeded by state banks was $3,114,035,000, the most drastic secession being in the group of banks of capitalization of 25 million or over, represented by 77.2 per cent of the total assets (see Table X). This group was represented by 4 banks in New York, 1 in Missouri, 1 in Michigan, 1 in Illinois and 1 in California.

The foregoing analysis indicates a tendency to-

ward a weakened federal banking system in competition with banks under more liberal state charters. This tendency has been recognized for many years and the McFadden Bill was enacted

TABLE IX

NUMBER OF NATIONAL BANKS SUCCEEDED BY STATE BANKS

| *Amount of Assets* | *No. of Banks* | *% of Total No.* |
|---|---|---|
| Under –$ 200,000..... | 35 | 13.3 |
| $ 200,000– 500,000..... | 60 | 22.8 |
| 500,000– 1,000,000..... | 53 | 20.2 |
| 1,000,000– 2,000,000..... | 33 | 12.5 |
| 2,000,000– 5,000,000..... | 35 | 13.3 |
| 5,000,000– 10,000,000..... | 17 | 6.5 |
| 10,000,000– 25,000,000..... | 22 | 8.4 |
| 25,000,000 and Over..... | 8 | 3.0 |
| | 263 | 100.0 |

Forty-one (41) states are represented on this list. California leads with 65; New York and Oklahoma are next with 21 each; Pennsylvania with 20; Texas with 13; Idaho with 10; the balance is scattered among the remaining states from one to six banks each.

*This wave of succession, therefore, is not localized but is national in scope.*

largely for the purpose of correcting this condition. It was claimed primarily that the prohibition of branch banking in competition with state chartered banks frequently permitting branch banking, at least in the larger cities, was responsible for the defection of banks from the national system. The McFadden Bill gave permissive legislation for city branch banking in states where such branch banking is already permitted. But the defection from the national system of banking has not been arrested by the McFadden Bill. The decline in num-

ber of national banks is due in part to the mergers already discussed, but also in part to the change of banks from the national to the state system, and in totality there has been in the latter months of 1929 a loss in assets of the national banking system.

The question might legitimately be raised at this point, whether it is of any great value to have banks in the national system in preference to their having state charters; whether it is at all wise to enact any legislation for the purpose of strengthening the national banking system.

There are, however, at least two valid reasons why it would seem sound to develop a strong national banking system. (1) The commerce between states is vested with national interests, and in order that it may be financed in an orderly manner it is necessary that there be a uniform system of commercial banking with a common standard under the direction and supervision of the federal government. (2) In times of financial stress the government has found that it could not rely upon the cooperation of state chartered banks in order to carry it through periods of stringency and to assist it in the carrying out of a national policy.

The first point seems obvious. Railroads, public utilities, and industrial corporations doing an interstate business need the services of a banking system that transcends state lines, whose clearance of checks, procedure for transmission of loans and credits and other banking services have a semblance of uniformity. The national banking system is a hand-maiden to a nationally developed industry.

Moreover, the need for such an agency whereby

the government may finance its operations is of great economic importance in normal times, but becomes of absolute necessity in abnormal times. The very birth of our nation promptly demonstrated to the legislators their woeful inability to finance the Revolutionary War without a banking system, and consequently one of the first acts of the Continental Congress in 1791 was to charter the First Bank of the United States. The fear that such a bank would place in the hands of a few excessive financial powers caused the canceling of the charter twenty years later. The bitter experience in the war of 1812, when the government again had no dependable fiscal agency through which to finance the war, resulted in the chartering of the Second Bank of the United States in 1816; the renewal of this charter being vetoed by President Jackson fifteen years later. We need not go into the many political features which contributed to the discontinuance of these two banks, but it is fair to say that outstanding of all other causes was the fear on the part of democracy of financial autocracy.

The Civil War and the years following again demonstrated the need of a national fiscal agency and this time a national banking system was established; but in conformity with the principle of decentralized financial institutions, the banking system of 1864 limited the chartering of banks to strictly local institutions and provided no head or any centrally organized or uniform movements of funds or intercourse in the newly created system. When experience demonstrated that the rigidity of this system made for the sluggish movement of

credit, virtually impeding its fluidity, and on several occasions was provocative of financial stress, the system was unified in 1912 under the present Federal Reserve System.

The system has justified the expectations of those responsible for its erection as an instrument to cushion periods of financial stress. Almost from the day of its organization, the Federal Reserve System has been confronted with extraordinary fiscal problems which without its flexible credit organization would have strained financial institutions and precipitated industrial crises. It faced problems of war finance within two years after it was organized and from then on the problems of inflation, deflation, adjustment and expanding industry. In each case the Federal Reserve Board was able to expand or contract credit and assist the country in its industrial adjustment. Its contribution as an aid to financing the war, a problem of extraordinary magnitude, in itself will always remain as an inducement to maintain a national banking system as a national fiscal agency in time of stress.

The membership of the state banks in the Federal Reserve System is a voluntary membership and one from which they may withdraw at pleasure, while membership of the national banks is compulsory. The stability and permanence of the Federal Reserve System, of course, would be greater if its entire membership were on a compulsory basis. However, there has never been any feeling along the line of fortifying the system by compelling all banks to join it. On the other hand, considerable constructive effort has been made in recent years for the

purpose of fortifying the system by inducing individual banks to join the Federal Reserve System, with negligible results in the agricultural sections. There are today approximately 7,500 national banks, members of the System by compulsion; then there are 1,168 state banks out of a total of some 22,000 state banks that have joined the System voluntarily. State banks that join the Federal Reserve System are not the country banks but the more important and financially intrenched institutions. Although there are over seven times as many national banks in the System as there are state banks, the assets of the national banks are only approximately 27.5 billion dollars as compared with 12 billion dollars for the state banks. The state banks in the Federal Reserve System averaged assets of 103 million dollars, the national banks averaged 2.8 million dollars. The small banks in the Federal Reserve System are virtually all national banks, and few of the smaller state banks have felt justified in joining the System. Even the larger state banks joined only during the war under the urge of the national drive for financial mobilization. No doubt the discount privileges have since held many of them within the System. The defection, therefore, from the national banks and from the Federal Reserve System has not been stemmed. If it is desirable at all to have a national banking system, it must be molded into a cohesive unit in order to make it more effective from the standpoint of public policy. It has been the aim of federal legislation when unifying the banking system to prevent centralizing the financial resources of the country. In other words,

## TABLE X

### Total Assets of National Banks Succeeded by State Banks

The schedule reflects the dollar figures of assets of National banks succeeded by State banks during the period from the passage of the McFadden Act, February 25, 1927 to July 6, 1929.

| *Size Group* | *Dollars* | *% of Total Dollars* |
|---|---|---|
| Under –$ 200,000....$ | 4,727,000 | 0.2 |
| $ 200,000– 500,000.... | 18,682,000 | 0.6 |
| 500,000– 1,000,000.... | 39,539,000 | 1.3 |
| 1,000,000– 2,000,000.... | 43,036,000 | 1.4 |
| 2,000,000– 5,000,000.... | 102,271,000 | 3.3 |
| 5,000,000– 10,000,000.... | 116,689,000 | 3.7 |
| 10,000,000– 25,000,000.... | 384,506,000 | 12.3 |
| 25,000,000– and over..... | 2,404,585,000 | 77.2 |
| | $3,114,035,000 | 100.0 |

The most drastic succession of assets was in the $25,000,000 and over group, since this group involved 77.2 per cent of the assets. This group was represented by eight banks, four of which are located in New York, one in Missouri, one in Michigan, one in Illinois and one in California.

The next largest group ($10,000,000 to $25,000,000) was represented by twenty-two banks, located as follows:

| | |
|---|---|
| Pennsylvania | 5 |
| New York | 5 |
| New Jersey | 2 |
| Michigan | 2 |
| California | 2 |
| Kentucky | 1 |
| Maryland | 1 |
| Missouri | 1 |
| Ohio | 1 |
| Texas | 1 |
| Virginia | 1 |
| | 22 |

the theory of national legislation has been unification without centralization. In fact, whenever a unifying institution set up by the national government gave any indication that it tended towards centralizing financial resources, it was immediately put under suspicion and ultimately was disrupted.

The present Federal Reserve System is in reality only a semi-governmental body, one that is owned and controlled by its member banks and whose chief function is to effect cooperation in the use of reserves and in discounts and to provide the treasury with a fiscal instrumentality. The government ideal has been the growth of unit banks, locally financed, managed and using deposits for local developments, but being cooperating members of the Federal Reserve System. As a matter of fact, out of 25,961 banks in existence, only a little over 8,600 banks, 7,500 of which are nationally chartered banks and were forced into the Federal Reserve System, have found it expedient and profitable to join the Federal Reserve System. Almost two-thirds of the banks in the United States, or more than 95 per cent of the state banks, are today outside any national unifying institution and the number dropping out is rapidly increasing.

The failure of the national banking system to expand in face of the bank systems limited by state boundaries would indicate that the system provides no important advantages, at least to the smaller banks and has disadvantages that encourage the defections. That a system inherently so weak may be

threatened by a chain banking system transcending state lines is, therefore, no unreasonable fear.

It must be remembered that the survey of chain banking merely includes those groups and chains of banks that are publicly so known, held together either by holding companies or individuals. In addition to these chains, it is likely that by interlocking directorates there are scores of additional banks held together in chains of which the public has no definite knowledge. The number given is probably an underestimate.

A recent organization of a chain bank in New York State serves to illustrate the procedure and capitalization of one of the larger of such organizations. The Marine Midland Corporation, a holding management company organized by New York banking interests to acquire ownership of banks and trust companies in New York State and ultimately in other states, was chartered in Delaware with an authorized capitalization of 10 million common shares, of which one million shares were offered at $60. The corporation is sponsored by a group of bankers and is built around the Marine Trust Company of Buffalo, the largest banking institution of the state outside of New York City. It is proposed that the Marine Midland Corporation apply for a charter for the Marine Trust Company of the City of New York as an affiliated organization in which the corporation will have a controlling interest with paid-up capital and surplus of about 25 million dollars. Of the capitalization of 10 million shares, 4 million has been used for exchange with bank stocks, 1 million was publicly offered and the balance of 5

million was retained in the treasury and available for further expansion. The following institutions whose combined resources are more than half a billion dollars have been acquired:

Marine Trust Company of Buffalo—Buffalo
Union Trust Company of Rochester—Rochester
The Manufacturers National Bank of Troy—Troy
Power City Bank—Niagara Falls
Cortlandt Trust Company—Cortlandt
Lackawanna National Bank—Lackawanna
Niagara Falls Trust Company—Niagara
Niagara Company National Bank and Trust Company—Lockport
State Trust Company—North Tonawanda
Workers Trust Company—Johnson City
Bank of East Aurora—Aurora
Bank of LaSalle—LaSalle
First Trust Company—Tonawanda
Peoples Trust Company—Binghamton
Union Trust Company—Jamestown
Orleans County Trust Company—Albion
Bank of Snyder—Snyder

Here we have an array of national and state banks whose capital, surplus and undivided profits total well over 50 million dollars and a group of banks which may develop into one of great financial strength and importance. But it is not the size of the group that gives pause, but the fact that the holding company controlling all these banks, the Marine Midland Corporation itself, is subject to no legal control from any source whatever, though it has volunteered to submit to state and federal bank examinations. Moreover, responsible and recognized

ownership of banks is here fairly well diluted though in this case depositors are protected by adequate voluntary capitalization. In the unit bank there is a double liability of stockholders to depositors. Such double liability is easily evaded in the ownership of a bank by a holding company.

We may turn from this publicly incorporated institution and pick out at random a chain of banks in Minnesota organized by one man operating four banks in Minnesota, two in North Dakota, one in Montana. Of the seven banks which he operates, two are national banks, the remainder state banks within three states. In other words, here we have one man operating a group of seven banks, some of which are under the supervision of examiners in Minnesota, others of examiners in North Dakota, others of examiners in Montana and others of federal examiners. Put more realistically, we have the spectacle of seven relatively small banks controlled by one man and examined by four different officials representing four different banking systems. The owner of this group need give no public account of his operations and is able to turn the bank to business uses other than banking, whereas the group of banks represented by the Marine Midland Corporation, Detroit Bankers, Northwestern Bancorporation and others have no purpose other than stable banking in operating the group; they welcome examination in order to encourage investment in the holding company by proving sound banking policies and attract deposits by making provisions for double liability.

In November, 1929, the public press reported the

death of an Oklahoma banker with the simultaneous closing of 12 small banks with total deposits of 2.5 million dollars and capital stock aggregating $310,000. Examiners gave as a reason for closing the banks "frozen assets" dating from land deflation of 1920.

Chain and group banks have developed in all but nine of the states of the Union. Three hundred and eighty-nine banks are held in 34 chains in Minnesota, 86 banks in 11 chains are in Illinois, 82 in 4 chains in Arkansas, 94 banks in 17 chains in New York, 77 in 18 chains in Washington. In total, when we add the chain and group banks with existing branch banks, we have, out of 26,000 banks in existence, some 6,000 banks either as branch banks or group banks. From the standpoint of numbers more than one-fifth of our banks are not independent unit banks.

If it is at all sound that a national banking system is needed, then the forces that are today diminishing and disrupting this banking system must be removed. At least one important reason why national banks find it expedient to give up their charters and take up state charters instead is the more liberal opportunity provided by states for the development of branch banking.

## CHAPTER V

### The Reasons for Branch Banking

DURING the discussion of the McFadden Bill, there developed four schools of thought on the subject of branch banking for member banks of the Federal Reserve System. First, there were those who favored branch banking for national banks without any geographic limits; second, those who favored branch banking confined within the states or at least the Federal Reserve district; third, those who favored branch banking extended only to the city limits; and fourth those who did not favor branch banking in any form. The third and fourth groups may be combined because city branch banking is not regarded strictly as a branch banking question.

Former Comptroller of the Currency, Mr. Dawes, opposing branch banking in the sense of extending beyond the city limits, clearly set forth the idea that city branch banking is no infringement upon the theory of the unit bank. He said:

"At the outset it should be stated that while the question of extending outside facilities in the form of offices or branches beyond the limits of the parent institution but confined to municipal limits is one that might be properly controversial, it does not, to my mind, involve the fundamental principle of branch banking. So long

as such an operation is confined strictly to municipal limits, it remains in its essence a community operation conducted for the benefit of residents by residents.

"It seems to me it is sufficient to say that these intracity activities do not run parallel at all to the operations which are involved in the extension of banking influence by direct control in the form of branches covering a whole state or limits beyond the municipality. If the principle of local control over banking facilities within city limits is recognized and such an operation is forbidden in one and permitted in another state, it would not be a real concession to any branch banking principle, since intracity banking is, after all, community banking as distinguished from state, district or national branch banking. The city is the natural unit under which all concentrated districts of population naturally operate. When branch banks become state wide in their operations the problem assumes a widely different aspect. They cease then to be institutions operated by residents for the benefit of residents. The monopolistic aggregation of capital into huge units is involved. The balance of the Federal Reserve System is materially affected."

We shall, therefore, define branch banking as an association of banking houses operating in more than one city or town, but all under the discretionary control of the board of directors of the parent bank and operating upon the capital of the parent bank. We have already pointed out differences between branch banking and group or chain banking, but it may be well for the sake of clarity further to define branch banking and discuss the arguments that are advanced in favor of and against it. It must be understood that our discussion is confined to an

## TABLE XI

### States Permitting, Restricting, and Prohibiting Branch Banking

| States which permit the establishment of branches—the "branch banking area" | | States which prohibit the establishment of branches | | States which make no provision by law—no branches in operation |
|---|---|---|---|---|
| In and outside home city | Only in the home city (or county) | Operation of existing branches permitted | No branches in operation | |
| Arizona | Kentucky | Alabama | Colorado | Kansas |
| California | Louisiana | Arkansas | Connecticut | New Hampshire |
| Delaware | Maine[1] | Georgia | Florida | Vermont |
| District of Columbia | Massachusetts | Indiana | Idaho | North Dakota |
| Maryland | Michigan | Minnesota | Illinois | South Dakota |
| North Carolina | Mississippi | Nebraska | Iowa | Oklahoma |
| Rhode Island | New Jersey | Washington | Missouri | |
| South Carolina | New York | Wisconsin | Montana | |
| Virginia | Ohio[2] | | Nevada | |
| West Virginia[3] | Oregon | | New Mexico | |
| Wyoming[3] | Pennsylvania | | Texas | |
| | Tennessee | | Utah | |

[1] Home county and adjoining counties.
[2] Home city and territory contiguous thereto.
[3] No branches in operation.

attitude to be assumed by Congress towards this important development of banking.

Such legislation will deal exclusively with the national banks and with such members of the Federal Reserve System operating under state charters whose state charters will permit them to take full advantage of the contemplated liberalized legislation. The member banks of the Federal Reserve System must here be separated from the many state systems of banks which already permit branch banking. Eight[1] (see Table XI) states expressly permit the establishment of branch banks, namely, Arizona, California, Delaware, Georgia, North Carolina, Rhode Island, South Carolina and Virginia. Some states, like Louisiana, Maine and Tennessee, permit branch banking within the county in which the parent bank is situated. On the other extreme, we have states which expressly prohibit any form of branch banking even within the limits of the city, such as Alabama, Arkansas, Colorado, Connecticut, Florida, Idaho, Illinois, Indiana, Minnesota, Missouri, Nevada, New Mexico, Texas, Utah, Washington and Oregon.

The existence of state branch banks in some of these states is due to the fact that they existed prior to the passage of prohibitory legislation and that the new legislation did not close out existing institutions but forbade the opening of new ones. In some states branch banking is not prohibited by law, but no branch banking permits are granted by state officials on the ground that the state laws do not expressly give powers to state officials to permit the

[1] Federal Reserve Bulletin, February, 1929, p. 197.

extension of branch banking, whereas in other states without legislation, permits are granted because state laws do not prohibit it. For practical purposes therefore, the states in which no permits are granted may be added to those that do not permit branch banking, including Iowa, Kansas, Montana, New Hampshire, North Dakota, Oklahoma, South Dakota, Vermont, West Virginia, Nebraska and New Jersey.

Many of the states have additional special provisions limiting the powers of branch banking. Thus new branches, even in California, must be approved by the State Banking Department which may in its discretion deny the branch upon rather broad grounds of public convenience. Arizona, while permitting branches without restriction as to location, provides that for each bank there shall be an increase of $15,000 in capital and surplus in excess of $50,000. In Delaware, a payment of $50 enables the parent bank to establish a branch anywhere in the state, but demands an increase in capital stock to the extent of $25,000 for each branch acquired. Branches of Georgia banks, it appears, may be established in cities outside of the state of Georgia.

Thus we find varying degrees of limitations or extension of the principle of branch banking with the various state systems. Our concern here is not with either the unification or even the future development of the state systems, but rather to what extent the federal banking system may be liberalized to include branch banking. Moreover, a liberalized branch banking act by Congress does not necessarily mean that national banks will be able

to spread branches throughout the United States. Obviously such a course is not demanded even by present changing economic needs, and has in it real dangers of overdevelopment. The geographic limitation of branch banking, whether it is to be confined within the state or within the Reserve district or within a prescribed area of economic influence, is a subject that must be worked out in accordance with a survey of the facts in which there should be taken into consideration specially the experience in the operation of chain banks. Our inquiry here is largely into the arguments that are being advanced for and against branch banking.

The Comptroller of the Currency, Mr. John W. Pole, has, in a series of addresses, gone further than any of his predecessors in favoring branch banking. His advocacy, however, was accompanied by three limitations: (1) that governmental supervision be further extended and intensified; (2) that each parent bank be capitalized adequately to meet the responsibility of operating branches, and (3) that the discretion over the establishment and over the removal of every branch bank be vested with the Comptroller of the Currency. He amplifies these limitations as follows:

"Under a branch system of this character it would be possible for the parent banking business to protect it against economic depression in any one locality or in any one industrial activity or business enterprise. It would then be able to extend to the country districts the same quality of banking services and the same safety to its depositors which the customers of metropolitan banks in large cities now enjoy. There would,

of course, still remain the question of incompetent management and in a branch system the question of management is of the greatest importance on account of the magnitude of the enterprise. It is to this end that it seems wise that governmental supervision be developed to the point where the supervising authorities can protect the public as far as is humanly possible in this respect.

"No weakly capitalized bank should be permitted to engage in branch banking and in the ordinary course of business it is not likely that such a thing would be proposed. Nevertheless, I am in favor of a statutory requirement for a minimum capitalization which shall be large enough to insure the protection of the depositors and to discharge properly the responsibilities incident to the operation of a branch system.

"One of the principal reasons why the scramble for branches under the McFadden Act, prophesied by many of the opponents of the measure, failed to materialize, was undoubtedly the incorporation in the act of the wise provision that no branch could be established without the approval of the Comptroller of the Currency. It was required that an application be filed by the bank setting forth the reasons why the branch was desired, such application to be supported by a formal resolution from its board of directors in authorization thereof. Further procedure involved the detailing of a bank examiner, having in mind the effect of the establishment of the branch upon the local community, upon the banking situation as a whole and upon the parent bank, and the filing with the Comptroller of the Currency of a full written report of this investigation along with recommendations from the chief national examiner. Upon the basis of this information and such other information as the Comptroller might acquire from the Federal Reserve Bank or from other sources rests the approval or denial of each application for the establishment of a

branch. This procedure has been sufficient to discourage any precipitate rush and this discretionary power lodged with the Comptroller of the Currency will enable him at all times to require a branch system to develop in an orderly manner."

The arguments in favor of a branch banking system are, first, that it is in line with the experience of every European country and Canada. During the same period and with the same agricultural depression in both Canada and the United States, the United States banking system suffered serious impairment by wholesale suspension of banks and consequent public distrust of the banking system whereas in Canada no failures attributable to the economic conditions occurred. Moreover, both in Europe and in Canada the concentration of banking systems and the development of branch banking are fully in line with the industrial development which has preceded and paralleled it, whereas in the United States the absence of a branch banking system has caused the entire banking system to lag behind the industrial needs of the country and is developing distorted currents within.

The failure of six thousand banks in eight years in itself forms an argument for those advocating a change in the banking system. Practically all of these failures occurred in country banks whose resources in totality are insignificant compared with the banking resources of the country, but in number they have been so large as to undermine public confidence in the stability and resources of the banking system. Such branch bank failures (see Table XII) as are included are less than .6 per

cent of the total in numbers and are less than 1 per cent in resources. The failures were mostly of relatively small institutions and two failures account for

TABLE XII

We have made an effort to ascertain how many of the banks that suspended during the seven-year period were operating branches. It has not been possible to determine this exactly, inasmuch as complete data on both member and non-member banks operating branches were not available until June, 1926, though fairly complete figures are available beginning with June, 1924. On the basis of the data available and on reference to the bankers' directories, we find that of the 4,513 banks suspended, 27 were operating 54 branches. The following statement shows the number of such banks, by states, the number of branches operated, and total deposits (deposits in thousands of dollars):

| State | No. of Banks Suspended That Were Operating Branches | Number of Branches Operated | | Total Deposits |
|---|---|---|---|---|
| | | In Head-Office City | Outside Head-Office City | |
| Arizona | 2 | — | 3 | 2,945 |
| California | 1 | — | 3 | 1,627 |
| Georgia | 9* | 1 | 27* | 6,318 |
| Louisiana | 4 | — | 6 | 1,089 |
| Maine | 1 | — | 3 | 843 |
| Maryland | 1 | — | 1 | 200 |
| North Carolina | 3 | — | 3 | 686 |
| South Carolina | 4 | — | 5 | 2,112 |
| Texas | 1 | — | 1 | 131 |
| Washington | 1 | — | 1 | 10,326 |
| Total | 27 | 1 | 53 | 26,277 |

* Includes 1 bank operating 20 branches.

more than half the resources. These branch banking organizations existed under state laws and have not had the safeguards proposed under a national system.

The establishment of branches representing strong central institutions would reestablish such public confidence, would increase deposits and would give the small communities a banking service equal to that given to the metropolitan centers. It would draw out hidden deposits and would also be able to augment the banking resources to accommodate more fully loans for liquid enterprises entitled to banking services. A failure of the branch bank would virtually be impossible unless accompanied by failure of the parent bank, and as Canadian and European experience indicates, the large central financial institutions are less prone to failure because of the diversified business to which their very size leads them both geographically and industrially, and secondly, because of superior management of which the smaller institutions are unable to avail themselves.

In brief, then, it is felt that branch banking will give a superior banking service to the small community unattended by present dangers of losses to depositors; that branch banking is the inevitable evolution of banking as it accompanies industrial development; that if branch banking is stifled a sort of deflected form of branch banking in the form of chain banking will develop. Branch banking within the law may be subjected to examinations in order to increase the stability and soundness of the banking system, whereas chain banking under any of its various forms is susceptible to grave banking abuses that cannot be controlled in the interest of public policy.

The objections to branch banking are voiced by

the mobilized militant country bankers who fear an invasion of their economic sphere of influence, an abridgment of their privileges and utter extinction alongside of branch banking. First and foremost it is felt that the independent unit bank will not remain alongside of branch banks, that ultimately the unit bank will disappear. Examples are cited of the virtual disappearance of all unit banks in Canada and in England as branch banking superseded them.

The objection is valid but for the immediate future the change may be cushioned by the type of permissive legislation that is passed by Congress. If we should accept the three limitations for branch banking outlined by Comptroller Pole, it is unlikely that the unit bank would be driven out of business through the establishment of a *de novo* branch simply because no Comptroller of the Currency would permit it. As Comptroller Pole says, "It is inconceivable that any Comptroller of the Currency, the proceedings of whose office are important public records, would ever lend his high responsibility to aid a branch bank unfairly to drive a local bank out of business."

That is not to say that a local bank may not find it to its advantage to close its doors and reopen as a branch bank of a larger central metropolitan institution. Bank stock is a commodity with a market value and if the holders decide to sell to a branch system, that is their right and privilege. Once a branch banking system has established a unit by the acquisition of a local bank, it is not improbable that this unit will draw heavily on the remaining independent local banks. In other words, the estab-

lishment of branch banking will have the same effect upon the remaining independent banks that the establishment of a chain grocery store has upon the remaining stores. They must successfully meet new efficient competition or they will probably disappear. Nor is it inconceivable that the unit banks will find, through the Federal Reserve System, a cooperative scheme for self-protection that is similar to the cooperative defense found by the independent stores previously described.

The fear of the extinction of the unit bank, however, lacks some validity when we consider that the branch bank is not necessarily the only form of competitive banking units that will invade the town. If branch banking is prohibited, chain banks, as has already been pointed out, will take their places. In either event, then, the survival of the unit bank will depend upon a new competition either against an open governmentally sanctioned and supervised branch bank or against chain banks outside the intent of the law. The chain bank will supply competition that is liable to be unwholesome and unfair, while branch bank competition will come only in response to needs of the community and will be based on sound methods of banking.

When we depart from the self-interest of a large group of independent unit bankers who object to branch banking, we enter a field of objection that has for its keynote that public policy demands the retention of the independent unit bank. In American development there looms the figure of the independent frontiersman who subsequently became the independent farmer and the independent business

man. Democracy in America, at least in fiction, means not only political democracy but also industrial democracy. This may not be true in fact, but it is the theory that Americans like to believe is operative in American industry.

The development of 30,000 unit banks in America compared with twelve independent banks in Canada and with less than twenty independent banks in the United Kingdom is looked upon by many as an additional bulwark for industrial democracy. The specter of concentration of America's huge banking wealth, now well into 70 to 80 billion dollars, in the hands of a few banks gives pause even to the most pragmatic examiners of the banking system. The public at large, and the legislator who echoes public ideas of economic democracy, fear this concentration of financial resources, and no matter how strong the trend, would welcome every known device to curb and check rather than to promote the development of such autocratic powers in a few hands.

In fact, it has been this specter, it has been this fear of the money ogre that has hitherto placed legislative impediments in the path of a national banking system.

We have already briefly outlined to what extent the fear of centralizing banking resources inhibited the country from establishing a sorely needed national fiscal agency through a national banking system. Every effort was made to keep the system finally established decentralized and to prevent its encroachment on the unit banks. The Federal Reserve System provides for the establishment of

twelve geographically divided reserve districts, each of them headed by a bank made up and controlled by the member banks within the district. These twelve Federal Reserve Banks, privated owned and controlled by thousands of its member banks, are then united under the Federal Reserve Board, a semi-private governmental body.

While it is difficult in a few words to define this new system, it is not unfair to say that the Federal Reserve Banking System in the United States is merely an instrument by which thousands of banks may cooperate in shifting deposits and reserves, in transfer of funds from surplus regions to deficiency regions, in cooperating for purposes of clearing checks and assets, and in acting as a fiscal agency for the government. Neither the Federal Reserve Board nor the various Federal Reserve Banks are profit-making institutions. In fact, the legal foundation of their existence is such as to discourage these banks from making profits. They may be defined as purely cooperative banking institutions, serving and safeguarding the unit bank.

Thus, the entire development of the banking history in the United States has been, at least from the standpoint of federal legislation, one that promoted and protected the unit bank and prevented the centralization of capital. However, it may not be amiss to point out that while this is the theory, in fact the banking system has been unable to escape the centralizing forces that have been operative in industry. Democratic as this theory seems, and though the figures of 26,000 banks would seem to bear out the assumption that legislation can act against eco-

nomic tendencies, centralization of the banking resources in the United States has taken place in spite of legislative impediments. One-tenth of one per cent of the banks in the United States today control over one-fifth of the resources. These include banks that are strictly within the law, that have developed as yet no chain banking or any form of branch banking not contemplated by national legislation. When to this small number are added a few of the powerful chain groups, it is obvious that the legal machinery cannot prevent the development of a banking system urged on by economic forces. Financial concentration has ceased to be a specter coincident with the coming of branch banks. It exists in spite of legislative fears and because it is a consequence of industrial amalgamation. Prohibition of branch banking may deflect the course of banking; it cannot prevent concentration of banking resources.

Those who oppose branch banking from the standpoint of social policy advance what they regard as a second possible evil. It is made the central theme of the argument against branch banking by the former Comptroller of the Currency, Henry M. Dawes. He argues that powerful metropolitan banks with a nation-wide system of branch banks mean competition and ultimate annihilation of the Reserve Banking System. In other words, Mr. Dawes contends that the sorely needed governmental fiscal agency established through the Reserve System is in danger of annihilation when it comes in competition with interstate banking systems with wide-flung branches.

As already pointed out, one of the chief objects of the Federal Reserve System is to keep credit fluid and evenly distributed throughout the country, on a non-profit basis, and in response to financial and industrial interests of the country as a whole. Once such funds on a large scale become centralized in metropolitan banks and their fluidity is influenced by central banks through its branches for purposes of profit and not in harmony with the needs of the country, there may result grave financial disturbances which in fact may be engineered by these profit-making institutions.

It is difficult to deny categorically the probable development of such a situation. And it is for that reason that in a later discussion we will examine the workings of these systems in Canada and England. It is sufficient to say here that the experience of none of the foreign countries justifies the fears of branch bank opponents. It is, however, germane to point out that the conflict is not between branch banks and independent banks, but it is between branch banks and chain banks. It is to be noted that centralization has taken place already, is going on and apparently is an inevitable accompaniment of industrial development; and that the unit bank has already succumbed in large numbers and is today in a critical position, threatened with extinction either by failures, suspensions or absorption into a chain system. In other words, if there is a threat against the Federal System by a branch banking system, that threat is made more real by the development of chain banks. A socially-minded government will have considerable control over a branch

banking system, enabling the government to bring it in line as an adequate fiscal agency and supply a banking service that will not throttle industry. On the other hand, chain or group banking is dependent for its good behavior on the intent of the governing banking group, being a development almost wholly outside the control of existing federal banking laws.

In fact, the danger that chain banking will attack the Federal Reserve System is much more real than that branch banking will do so. Since chain banks are organized outside the legal banking system and thus are able to direct banking business into lines of specific interest to the managers of the holding company, it has many attractions as an organization over branch banks. We are, therefore, not surprised to find that in many of the states with liberal laws for branch banking there exist, side by side with legalized branch banks, powerful groups of chain banks. Thus Arizona permits branch banking, but one chain in this state controls six banks with 21 million dollars in resources. California has a liberal branch banking law, but within the state we find seven chains, variously controlled, with 42 banks having 1.3 billion dollars in resources. Five other chains controlled by individuals unify 16 banks having 17.6 million dollars in resources. Georgia prohibited branch banking only in 1927, but since then has authorized additional branches in metropolitan areas, but we find chains with 24 banks having 221 million dollars in resources. Minnesota at present prohibits branch banking but permits the operation of existing branches, yet during the period of the establishment of branch banking in Minnesota,

there also developed 34 chains including 435 banks with 995 million dollars in capital.

In short, liberal branch banking laws do not necessarily eliminate chain banking. In fact, the superior advantages in management and overhead savings of branch banks as compared with the more clumsy and indirect form of management of chain banks is compensated in some way and enables chain banks to grow side by side with branch banking systems. In many instances, of course, this is due to the greater ease of acquiring chain banks, which has already been pointed out, yet it may also be due to the fact that chain banks have greater freedom in the management of their subsidiary banks than has a branch banking system. It is not certain that if well-considered and prompt action were taken by the federal government to establish a branch banking system, such action would necessarily interfere with a growing tendency toward chain banks, at least not for the present.

If the advantage is solely one of acquisition as outlined before, then it is entirely probable that we will have three stages in banking. First, the independent local bank, second, the unification of the local banks into chain banks, and third, the conversion of chain banks into branch banks. Assuming the intent of any chain banking system to conduct these banks for banking purposes, the only basis on which it is assumed that such a system can survive, once the steps of amalgamation toward chain banks have been taken the savings in overhead and the ease of management would necessitate the additional step towards branch banking if legislation in that direc-

tion is eased. In any event, we return to the original point that the question facing the banking world is whether it will submit to chain banking or branch banking; that the independent bank in either contingency faces one horn of this dilemma and that the Federal Reserve System, if it is endangered as a fiscal agency, stands in greater danger from a banking system controlled by holding companies than one over which it exercises supervision and some direction.

## CHAPTER VI

### Branch Banking and Stabilized Agriculture

THE citadel of the unit bank is in the agricultural regions. It is here that 90 per cent of the unit banks operate and here that the unit banker resides in his pristine glory and influence. And it is here that the banking system shows its greatest weakness.

The agricultural debacle has had its repercussion on the banks. The failure of 4,500 banks and the imminence of many more thousand bank failures, in great part, must be attributed to the persistent depression in agriculture, one that in face of a decade of unparalleled national prosperity has left millions of farmers in poverty and in distress. Yet from these very regions, from bankers who preside over financial institutions that serve the agricultural districts, comes the mobilized and organized objection to any change in our banking system. In the ideal form, there is something rugged and lyric in the quality of idolization of the independent unit banker as he is seen by those who love him. We cull the following from a speech given at the American Bankers' Convention:

"In the smaller towns, the scheme of life is not complete without the unit banker; men like Callie Harris in the town of Franklin, Kentucky. Benign faced, with a

smile for everyone, an optimist in all emergencies; family and business adviser to every patron or friend; trustee of every church or hospital loan; executor when men died—dedicating their souls to God, and their estates to the banker. He befriended a poor foreign peddler with his pack on his back, nursed him from death's door back to life. This peddler became a great and successful merchant and when he died, his will gratefully gave his large estate to this banker. When Mr. Harris was buried, nearly every man, woman and child in the county came to drop a flower on his red clay grave. Replace such a man by a city clerk awaiting every morning a circular letter, or his master's voice out of a loud speaker's horn? God forbid."

One rather hesitates to introduce a note of dissonance, to point out that the song of praise of Mr. Harris, while probably deserved, and deserved by a large number of bankers, is not necessarily typical nor in harmony with existing conditions. There is a quality of myth in it, in so far as it represents a banking saga of a passing age. Under modern conditions and in certain regions, this country banker would be unable to serve the community as he did when banking grew with the country and was more profitable.

Because of the effect of agriculture on banking and because of the resistance of bankers in the agricultural regions to any change in the banking system that will hasten their exit from the banking stage, the question of branch banking as it relates to agricultural relief merits special attention.

The critical condition of the farmer has been heralded by his articulate spokesmen in Washington and in the agricultural press. It need be rehearsed

here only in so far as it clarifies the relation of the farmer to credit and banking. We may accept as a fact that agriculture does not pay for the average farmer; that the average farmer is earning, according to a number of surveys, an income of less than $800 a year, a wage from which a stevedore or a coal heaver would turn with scorn. When we have a group of 6½ million farmers who with their families make up a third of our population, whose labor and savings go to produce the most fundamental needs of the nation, and who in return receive an income less than that given to the most shiftless and unskilled group, we have material for an agrarian revolt such as is present nowhere else in the world and which merits thought when considering policies that involve a change in the economic institutions that serve him.

The emergence of the farm problem to foremost national attention is not due to farm distress more acute today than it has been for the past quarter century, but rather it is the result of an incessant campaign on the part of the farm leaders to seek through law some change favorable to the farmer's economic status. The flood of recent legislation started in 1920 with the Fordney Emergency Tariff Bill. The Farm Bloc was organized in 1921. There followed a series of measures relating to cooperation, rural credit, packers and stockyard control, grain futures, commissions for agricultural inquiry, agricultural conferences, freight rates, and a host of minor acts.

In 1924 the first McNary-Haugen Bill was defeated by the Congress, followed by a flood of

controversy that reached new high levels for agricultural interests. A revised McNary-Haugen Bill was again defeated in 1925, followed by the introduction of a bewildering variety of substitute measures. The third edition of the McNary-Haugen Bill was introduced in 1927, and this time was passed by both branches of Congress, but was vetoed by the President. A fourth edition, only slightly modified from that of 1927, was passed by both branches of Congress in 1928, but was again vetoed. Farm relief became the chief issue of the 1928 political campaign, and after the election of Mr. Hoover, a special session of Congress was called early in 1929 to pass the bill creating the Farm Board, with an appropriation of a half billion dollars. A farm tariff bill met with a coalesced opposition of Democrats and Progressive Republican friends of the farmer, when it was attempted to smuggle industrial schedules through Congress as riders to the agricultural tariff bills. Politically, therefore, the subject of farm relief has been exhaustively reviewed. The economic roots of the problem, however, have not been brought forcibly to the front.[1]

Prior to the war, agricultural discussion, if any, centered around the interests of the consumer. The important agricultural exports to which the country had become accustomed during the late eighties were declining sharply. From its very inception these exports had been a sort of historic appendage to the economic life of the country. After 1900 there was

[1] Cf. *Harvey Baum—A Study of the Agricultural Revolution*, by Mead and Ostrolenk. Published by the University of Pennsylvania Press.

also some rise in the cost of living, and the fear of hunger began to haunt statesmen. The Country Life Commission was appointed in 1906. The cry "Back to the farm!" was heard in the land.

But the war had seen agricultural exports rise to new high levels. It had shown the extraordinary ability of agriculture to expand under price stimuli. It had given indubitable demonstrations that the country was far from starvation. The present agricultural discussion arises not from any fear of a food shortage, but rather from the burdens of an agricultural "surplus." As a result of war expansion the farmer is producing in quantities that cannot be consumed. He is producing something that is not wanted. Hence his rewards are low, and hence his cry of distress.

The farm problem grows out of a technical revolution in the practice of agriculture which is not less truly revolutionary, and which imposes scarcely less hardship on many of those it affects, than the Industrial Revolution of England, which put an end to household manufactures and workers and inaugurated the factory system.

But it is one thing to admit the existence of a great economic and social problem; it is quite another to see that problem for what it actually is, to admit the facts which constitute its reality, and to face the question of a solution with complete frankness.

In the case of the farm problem it is exceptionally difficult to practice the frankness and directness of thought which everybody recognizes as the only tolerable attitude in problems purely economic and

scientific. For, besides being an economic and technical problem of the first magnitude, the farm problem also involves a great social conception. President Hoover has pointed out that farming in this country has been considered above all else "a manner of living"—the characteristic base of the American social fabric. This in fact is the popular conception of the farmer's place in the nation. Like most popular notions it is probably wrong but, right or wrong, it is the conviction of political and social leaders that the farms form the head reservoirs from which the cities, industry, trade, finance, religion and education have drawn many of their ablest leaders; and in common thought the preservation of the farm population has come to mean preservation of an essential social function.

Moreover, besides representing a basic American social conception, the farmers represent a great political power in national legislation. The purely agricultural states are represented in the Senate on an equal basis with the predominantly industrial states; and, with their considerable body of members in the lower house of Congress, the farm states have altogether an important balance of power. Thus political influence, tradition and sentiment combine to urge ever new assistance to agriculture —assistance which will pacify the farmer, but which makes it extremely difficult for any man of political ambitions to act and vote with an unbiased facing of the farm problem as it actually is.

But the revolution in agriculture, like technical revolutions in other industries, has no mercy on social and economic institutions anchored to a back-

ward state of the practical arts; and the new scientific agriculture of today is rapidly destroying the old foundations of farming as a manner of living, replacing them with a new order which we may for a time ignore but cannot indefinitely oppose. This new order has made far greater advances than is generally realized. Indeed, the new farming has already established itself and all that we can do about it now is to foresee the consequences and to lessen as far as may be the largely inevitable burden of them. This can be done by basing the agricultural relief program, not on the emotional wish to retain the entire present farm population of 6½ million farmers, with their wasteful overproduction, but on the willingness to face the fact that this burden of the surplus can be reduced only by a reduced number of farmers. In other words, farm relief means farm migration to the city—a migration that should be developed, encouraged and assisted.

The main instruments of the present agricultural revolution are as follows: first, scientific agriculture, thought out and in fact created by the federal and state governments, which shall prescribe the rules by which intelligent and energetic farmers may be assured of crops much larger than the average. Second, gas-driven farm machinery. This has enabled larger, more complicated and heavier machinery to operate on the fields than was possible with horses; it has increased the productivity per man; it has replaced millions of horses and freed fodder acreage for human consumption. It has reduced the unit cost and has tremendously increased production.

These two agencies together have divided the country's whole farm population into two unequal parts. One of these parts is prosperous and contented; the other part embodies the farm problem. The prosperous part is the small minority of farmers—probably not more than one-eighth of the country's entire number of about 6,500,000, say, 800,000—who by the practice of scientific agriculture and the use of modern machinery can raise crops at so low a cost as to leave a wide margin of profit between that cost and the average market price. The remaining seven-eighths constitute the farm problem.

The concrete farm problem, then, is how to keep the unprosperous seven-eighths majority on their farms and to bestow on them a satisfactory measure of prosperity. At least this is the way the problem presents itself to those who seek a solution that will at the same time retain the present farm population.

But the inescapable final result of the agricultural revolution is to make fully one-half the present crop acreage and one-half the present number of farm workers progressively superfluous, and to drive the latter away from the farmers to employment in industrial centers. This elimination of the unsuccessful farmer and his family has been in progress for several years; the total migration of such defeated farm families from the farms to urban industrial centers since 1920 is estimated at about 4,000,000 persons. This migration will continue, unless progress in agriculture stops. We know, however, that progress will not stop; on the contrary, it will

advance at an accelerated pace. The migration has not been fast enough to keep up with the advancing agriculture. The danger is that it will not be rapid enough in the future to avert suffering and poverty.

"The period of transition from domestic to factory system of industry," says Cheney, "was in England one of unrelieved misery to the great masses of those who were wedded to the old ways, who had neither the capital, the enterprise, nor the physical nor mental adaptability to attach themselves to the new. The hand-loom weavers kept up a hopeless struggle in garrets and cellars of the factory towns where their wages were sinking lower and lower, until finally the whole generation died out."

No law could have stopped or stayed the Industrial Revolution. With those who are similarly being driven from the practice of agriculture in this country, the alternative is not misery and starvation, but the difficult task of finding a place in new occupations, chiefly in the industries of the urban centers. It is a formidable problem to find employment for 15,000,000 additional workers in industry, but one that is not insuperable, one that if honestly faced can be solved with infinitely less disruption during the next ten years than was caused by the placing of that many workers coming from Europe to America during the period of immigration of a million a year. The movement is inevitable. The danger is not in the movement itself, but in self-deception, in false "solutions" that will attempt to arrest it, or in the ignoring of it.

The fundamental aspects of the farm problem,

then, are (1) that a revolution in agricultural technique has increased production far beyond the nation's ability to consume; (2) that in the main those ground down by the pressure of declining prices are largely in that position because of the surplus production. In the face of this situation it is rather odd to hear, as an outstanding proposal for relief, the advance of the idea that the unsuccessful seven-eighths of the farm population may become prosperous in agriculture by following the example of the scientific one-eighth, involving proper soil maintenance, improvement of live stock, more intelligent feeding, larger use of machinery, and better organization of farm operations. Among laymen and bankers this idea has wide prevalence. The president of a national farm school publicly delivers himself thus: "The potentialities for a happy and permanent rural life are a love for the soil and the ability to make it yield its best results." Stripped of its pompous verbosity, the pronouncement declares that the farmer's ills can be cured by increased production.

This exhortation to the farmer to improve his methods and thus reap the profits won by his successful neighbor has elements that make it attractive. It puts the onus of the farmer's failure on the farmer. It does not involve government aid to private enterprise nor the setting up of new and feared institutions of distribution. It eschews politics. It does not raise prices.

It must be granted that this method of solving the farm problem does indeed solve the problem for any one farmer. The example of the one-eighth

demonstrates that he who follows the scientific methods advocated by the various agricultural colleges can at present prices reap satisfactory profits. The same solution will work for any ten farmers, or for any thousand farmers, or even for any hundred thousand farmers. But when we come to apply the remedy to the six and a half million farmers involved, we are obviously headed for an abyss.

We produce today for domestic use and for export 800,000,000 bushels of wheat annually. This is at the low average of thirteen bushels per acre. This average yield could easily be doubled on average land by skillful farming. Besides the 200,000,000 bushels of wheat normally exported, we should have an additional 800,000,000 for export, or a total of 1,000,000,000 bushels. This amount would be twice as great as the present imports into Europe from Canada, Australia and Argentina, the principal countries now exporting wheat to Europe, and would be equal to the total domestic production in Europe. Who would consume this increased production?

The same can be said of corn, of pork, of potatoes. Who would eat the additional quantities produced? The effective demand for the deluge of farm products would disappear.

Increased efficiency, while the salvation of any one farmer, would be the ruin of the masses. Today the efficient farmer succeeds because his neighbors fail. His prices are good because their crops in totality are low. If the seven-eighths could by some miracle be made efficient, it would precipitate an economic catastrophe beside which the overproduc-

tion catastrophe in Georgia cotton in 1926 or Maine potatoes in 1928 would seem a prosperous condition.

An important group of farm well-wishers sees a solution in cooperative organizations. They see the farmer forced to sell in markets over which he has no control and behind which move vested interests with sinister designs. One type of cooperation advocated consists of the purely marketing association, which would secure for the farmer the best prices, would assist him in warehousing and financing his crop, would reduce the cost of marketing, and would help him to develop new markets. Such marketing associations have been successful in securing as high as 10 per cent in additional prices to the farmer, a saving not to be despised. Most of the organizations have not done as well, and many have failed, presumably because of inability to compete with the efficient avenues of trade. However, even the best of these organizations fall lamentably short of the price goal desired by the farmer. He wants a price of $2 a bushel for wheat. No cooperative has as yet been able to squeeze more than 5 cents additional for the local shipper from the highly competitive market which fixes the price around $1. The cooperative in other commodities also falls far short of the desired price to maintain the seven-eighths. It gives a 10 per cent increase at most, but a 100 per cent increase is desired.

Another type of cooperative is one that would by contract corner the farmer's product and then fix a monopoly price. Discussion of the point is academic, since all such efforts thus far have failed. The reasons for such failures are obvious and need

not be gone into here. State and federal laws cleared the way to permit such organizations, which would ordinarily come under the antitrust laws. Their failure was to be expected, since they did not attack the problem of overproduction; they were confronted with ever-increasing burdens of surpluses, which could not be sold, no matter what the type of selling organization. Added to this were the internal troubles of such an organization built on a mixed membership, with rising external competition. Success would have been a miracle. Even to the layman it would seem that this is an economic problem, one of overproduction, and that a shift from less productive land and lesser skilled farmers to the cities is an inevitable consequence. It is necessary to reduce the number of farm workers and the amount of land and the invested capital in the production of crops that are neither needed nor can be consumed, and whose production brings neither happiness nor profits to the producer.

But, as already indicated, it is one thing to recognize a purely economic problem and quite another to deal with it in a scientific way when it involves the fortunes of 6,500,000 farmers with their families; farmers who have been fed with laudation as to their importance as stabilizing social elements, and who moreover have become politically articulate.

For eight years the farmer has been deceived and lulled into a dream that his economic troubles can be cured by law. He still labors under that belief. In the latest political move to appease the farmer's vociferous cry of distress, Congress has appropriated

half a billion dollars with which there are to be set up crop-withholding cooperative organizations, hazily defined, whose operations, it is hoped, will bring prosperity to the farmers. A cursory examination of this or any of the other political programs, planks and platforms, the enactment of agricultural tariffs or the diversified number of loan agencies which make public funds available as farm credit for the amelioration of agricultural distress, show that none of these proposals touch the fundamental aspects of the problem—that of overproduction. Their weaknesses are obvious.

Agriculture is not a local industry. The American farmer sends his pork, cotton and wheat to the farthermost ends of the world. Cotton goes to England and Japan, wheat to all European countries and to the Orient. Pork goes to Germany and France. Butter from Minnesota is sold in New York and in New Orleans. Fruits from California cover the continent, and vegetables from Florida, Georgia and New Jersey travel north and west to the farthest boundaries of the country. In other words, we have in agriculture a national and international industry, in the aggregate the most important in the United States, consisting of half the total exports of the country. In the past twenty years the value of American cotton exports alone has been greater by four billion dollars than the world's production of gold during that period.

But in reality this gigantic productivity, with its world-wide sweep of markets, is produced by millions of small units, farmers most of whom produce on the family-sized farm of less than 150 acres; the

cotton crop being produced by millions of farmers "on twenty acres and a mule." These farmers are not in touch with the markets. They are financed by thousands of small bankers who also have no direct contact with world influences that bear upon price, who are often personally tied up with the fortunes of the local farmers and whose vision and banking interests do not extend beyond local fields. The unit banker sees only his local problem. Neither he nor the farmer is sensitive to any world changes in consumption.

It is the middlemen, the jobbers, shippers, wholesalers and exporters, those in charge of the warehouses and packing houses along the seaboard and in metropolitan centers, who are in touch with world trade and with world markets. It is they who protect their profits at these points of concentration and have at their disposal large-scale financing by the metropolitan banks. The metropolitan banks now finance the warehousing, transportation, insurance; their credit now carries products across to consuming centers; they deal in exchange and acceptances. In short, the bankers are in close touch with the position of the crops from their point of entry as a financial agency to the point of consumption.

It does not require a great stretching of the imagination to assume that if these larger metropolitan banks would reach down into the towns and villages of America and there touch the farmer, that the banks would then form a direct credit road from world consuming centers to the man who plows his field. That contact would have immediate conse-

quences. It would deal with the agricultural problem realistically rather than sentimentally. Credit would be eased for those farmers and along those lines of productivity that are profitable and credit would dam up for submarginal farmers. The independent kindly banker may have been, especially in the early stages, an important factor in developing the agricultural resources of the country, but as an adviser to the farmer and as a guide to agricultural production he has become as important as his bank.

Nor is it so certain that the unit bank and the optimistic bankers were such a boon to the agriculture of the country. Certainly, agriculture today in large part suffers from the overdevelopment of land and agricultural resources in which the optimistic and affable unit banker had a major part. When after the Civil War the demobilized armies, from both the North and the South, met with the depression in industry customarily accompanying the disruption caused by war, American agriculture started on a path of expansion that has led to repeated farm debacles. Post-war unemployment in the North and desolation in the South turned the demobilized Union and Confederate armies into a horde of land-hungry agricultural exploiters. From the adventures of war they turned upon the opportunities of a virgin, fertile American empire. At the heels of the war veterans came an avalanche of immigrants. Knowledge of free, fertile land in America had spread through northern Europe. They flocked to America. They came direct from the overpopulated lands of Europe to the people-less lands of the Northwest. Supplementing both groups

came a migration of farmers from New England who abandoned the rocky, niggardly soil of the East for the stoneless, fertile prairies of the West. Wave upon wave of settlers filled the north and central West. They sought out the fertile lands and filled every nook and corner that gave promise of productivity. They pushed on to the less fertile land. They poured into the semi-arid regions of Nebraska, Kansas and North Dakota. Land-hungry home-seekers rushed to the arid lands in the hope of promised irrigation. Swarms of real estate promoters and land speculators masquerading as unit bankers contributed with unabating energy and confidence to this rush to subjugate the prairies.

The orgy of agricultural development continued, but there began to be evidences of its futility. It was a romantic and epic conquest of the land resources of the nation, but its impetus sent food production far beyond the effective demand. It was the homage humanity pays in suffering for planlessness, for faith and for folly. For it brought no profit. Prices dropped but the agricultural orgy continued. The settlers consoled themselves with the paper profits of rising land values. Farming had ceased to be profitable but farmers were willing to toil for mere existence in the hope of the speculative wealth supposed to lie in the new land values. Mr. Hoover's conception of the farmer, one who was willing or able to live by his toil on the fruits of the earth, existed rarely, and often only in the minds of poets. The farmers who filled the West were really land speculators aided and abetted by bankers.

The World War again was the supreme test of

American agriculture. The food supply of the allied nations, now normally coming in large part from other than United States sources, notably Russia, Australia and South America, was curtailed by blockade and submarine. There was a protected ocean lane from America to Europe through which food for the military and civilian population could travel with reasonable safety.

The American farmer rose to his opportunity. This was a field in which he was at home. Exports which had fallen sharply after the first land orgy had spent itself again rose. All previous records were quickly broken. The five-year average of wheat export during the war rose to 255 million bushels, or two and a half times the five-year average just before the war. As an average it was a greater amount than any previous annual export. It was greater by 50 per cent than any previous five-year average. Exports of oats rose from 10 to 83 million bushels; rye exports mounted from a million bushels to 26 million; beef exports doubled, and pork reached new high levels. Neither during nor after the war did the country bankers lift hand or voice to warn of the consequences of this new impetus in production. In fact, they contributed with all their might to the boom, and the subsequent collapse of the farmer carried his fellow land speculator, the banker, down with him to financial disaster.

As the curtain fell on the post-war period ending in 1920, agricultural production was at its peak. It had developed in accordance with the American historic policy as an export commodity with production far beyond the demands of the country. Agricul-

tural products had been in demand abroad but payments had been made, during the war, out of moneys loaned by the American government to Europe, and after the war, out of proceeds of private loans. The instability of this international trade had had no opportunity to impress itself on the American farmer, and the local banker was as innocent of these implications as the farmer. The rush for rural development had received new impetus and was aided by all the resources of the unit banks. It was pursued with a passion reminiscent of the middle eighties and early nineties. Land values had risen 92.5 per cent. Long-time improvements, including roads, bridges, schoolhouses, involving higher taxes and greater interest payments, had been undertaken. The agricultural investment had mounted from 40 to 78 billion dollars, or almost double the pre-war investment. Farm mortgages had increased 131 per cent, representing not only additional capital improvement, but considerable expense and outlay for luxuries and semi-luxuries in the home. Expensive machinery and farm improvements had been installed. Rumblings of an impending crash came in the latter part of June, 1920, but in political circles, ignorance of international economic conditions was as abysmal as was that of the farmers and unit bankers.

On June 10, 1920, the Democratic party met in convention in San Francisco and viewed with alarm the increasing prices of food. Its platform stated, "The simple truth is that the high cost of living can only be remedied by increased production——" This at a time when agricultural production was

staggering towards the disaster of the century. Mr. Cox, the Presidential nominee of the party, in his acceptance speech, fully endorsed this sentiment. He said, "Common prudence would suggest that we increase to our utmost our area of tillable land." In the Republican Convention a week later, Mr. Lodge in his keynote speech asserted, "The most effective remedy for high cost is to keep up an increased production; particularly should every effort be made to increase the productivity of the farms." These utterances may be regarded as closing the war era. Within a few weeks the curtain rose on the tragedy of the American farmer. Within a few weeks, wheat, typical of all agricultural commodities, dropped from $2.04, the price at the time of these utterances, to 93 cents a bushel.

The unit banker had aided and abetted this exuberant production and development. Though always suffering with the farmer from repeated financial setbacks, he readily loaned on increased land valuation and vied with the horde of real estate agents to place at the disposal of a vast population of semi-farmer-land speculators the resources of the banks. At no time were land values adjusted to income. The unit banker, like the farmer, had a local viewpoint only. He was untouched by world movements which after 1900 were shifting wheat production into new areas and were revolutionizing sources from which European consumers were drawing their supply. For a quarter of a century the wheat producers and their bankers have been a prey to forces which they felt but did not understand. And the

banker had no economic contacts or vision to envisage the post-war agricultural debacle.

It seems highly improbable that with the development of branch banking, whereby banks with international connections will also reach into producing centers, American agriculture will continue its economic chauvinism. The local agent in charge of the local branch bank, while probably not of the same dynamic and elemental personality as the disappearing unit banker, will, nevertheless, be able to bring to the American farmer a touch of the realities of the primary markets. It is entirely probable that he will contribute more to orderly production, to economic adjustment and to the prevention of chaotic marketing than any other agency yet devised and designed to rescue agriculture from its continued economic depression. He will work in consonance with economic forces. We shall have occasion later to show that the seeds for such corrective pressure have already been successfully growing in branch banking systems in some of the states and in Canada and Europe, and to demonstrate that branch banking as a form of farm relief is not wholly academic; but at this time it is sufficient to point out that the unit banker has not been an unmitigated blessing to American agriculture.

The most important service of a branch bank manager would be a new distribution of credit on the basis of needed productivity. The farmer has been suffering from an excess of credit—credit which supplemented the uncritical allowance from the unit banker with that supplied to him by the national

government through Farm Loan Banks, Intermediate Credit Banks and Agricultural Finance Corporations. Yet when we come to examine the financial transactions with semi-governmental loan agencies, we find that in reality the mortgages given through Farm Loan Banks must be amortized, a procedure that prevails in no other industrial credit; short-time loans secured through Intermediate Credit are mythical and in most instances can be secured only at the pleasure of bankers who are mostly unwilling to accept the smaller broker's fee for transmitting the loan, and prefer to loan their own funds at larger rates since they are endorsers of the note to the Intermediate Credit Bank; Finance Corporations serve only cooperatives in a limited field whose products can be warehoused.

On the other hand, a form of credit which has become extensively used by merchants and international trade, such as acceptance notes, is unknown in agricultural financing. The credit that farmers secure on notes to merchants and dealers in the purchase of fertilizers, feed and machinery is expensive and wasteful. The entire problem of credit for agriculture needs drastic reorganization, redirection, diversification and development. The country banker, in the very nature of things, has been unable to supply these conditions, because they demand stimuli originating from national and international economic conditions.

Summarized, the overexpansion of agriculture resulting from the two wars—the Civil War and the World War—has not been checked. Three administrations have wrestled to solve the problem of agri-

cultural surplus by law, with negligible success. The depressed agriculture has demoralized the country banks, which in turn have been unable to be of service to an industry divided into small units and in the aggregate subjected to international forces. There is every hope that the development of a banking system that will reach, on the one hand, into the regions of production of agricultural products and, on the other hand, into the regions of consumption, is likely to have decided influence upon a more orderly production and marketing, an influence certainly of greater consequence than may be secured by any political procedure that ignores the economic roots of the problem.

## CHAPTER VII

### Branch Banking and Stabilized Business

ECONOMISTS have made the business world familiar with the alternating business cycles of overexpansion and subsequent depression. These recurring phenomena have come with such regularity that there exists today a school of economists who expect the recurrences with mechanical and mathematical precision. The theory is that production and distribution continue to grow in a rising market, and in fact tend to overtake consumption with stock beginning to accumulate in factories, in warehouses, in wholesale plants and in merchandising establishments, until a point is reached when the credit of the country is unable to carry these increased stocks, the turning point usually being the bankruptcy of some large firm with the sudden realization of the excessive stock values. There follows a recession of production, resulting in decreased employment and diminished business activity all along the line as cumulative decreased consumption accelerates the depression, which then runs its course and gradually is converted into a new ascending cycle of business activity.

This may be an accurate description of cyclical business activity for many years before the war. As a matter of fact, industry and merchandising estab-

lishments have begun to appreciate that these cycles are not necessarily the inevitable accompaniments of business activity as irrevocable as the laws of the Medes and Persians, and have learned to adjust their business to prevent undue expansion of stocks and inflation of prices, and thus attempt to avoid overactivity to be followed by industrial depression.

It has become a fundamental principle of business precepts carefully to watch stocks. Merchandising establishments have become particularly insistent upon rapid turnovers, to clear the shelves at short intervals and to keep nothing on the shelves except such merchandise as will sell rapidly. Purchases are made from hand to mouth and only in accordance with the turnover experience which is statistically and carefully charted.

Similarly, wholesale establishments are adjusting their prices with hair-splitting finesse, based upon the stock situation of production. The existence of mercantile institutes is justified by keeping the trade informed of the stock situation. The monthly into-sight movement of cotton, its consumption and stock situation, are turning points in the price of cotton. The same thing may be said for cotton yarns, for silk, silk stockings, hides, boots and shoes, automobiles, for steel and scores of other basic products in industry. Not only the trade, but the entire business community is publicly informed of the stock situation within the various industries and an abnormal increase in stocks indicating business expansion beyond consumption has its repercussion on prices and discourages and checks additional production or encourages additional consumption.

It is not improbable that in damming up stocks back of retailers and wholesalers, new problems of production and warehousing have added to industrial confusion but in the main it is considered that prevention of stock inflation has aided in balancing business activity. There is beginning, in fact, to be some feeling that this policy is being carried too far and is weakening the industrial fabric. When economists in recent years began to speak of the "new era," they had in mind this very condition by which it was hoped that the disturbance in business accompanying the periods of undue business activity, followed by business depression, had been flattened out and had been replaced by a continuous balanced business activity which stabilized production and consumption.

It was, therefore, somewhat of a shock when the interference of the stock market during the years just before 1929 threatened to invade this supposedly stabilized business activity. The sudden collapse in value of securities, late in 1929, had a staggering effect on business, along the same lines that the accumulation of stocks would have had. The speculative activities of the stock market had been ignored by industrial leaders of the nation and certainly it was felt that it was beneath the notice of either Congress or the Administration. When the crash did come, there came from all business leaders, as well as from the President, the Department of Commerce and all who were apprised of the business situation, the assurance to the country that business was sound as measured by the fact that production had been adjusted to consumption and distribution. To be

sure, business was sound as far as industry itself was concerned, but production had been adjusted on a consumption demand which was far ahead of the nation's earning capacity, was in fact based on fictitious speculative profits and in reality ate into the country's capital reserves, hence in the business situation of the country the stock market could not be ignored. It is, in fact, an important item in the stabilization of business activity and from that standpoint, the attitude of business leaders and of legislators, that the stock market is a speculative outlet of no consequence to the business interests of the country, has proven wrong. The experience here clearly presents a factor that needs to be included in the calculations of stabilized business activity.

Almost instantly after the collapse had occurred, both economists and legislators recognized the heavy responsibility that rested on the banks of the country as stimulants of the speculative mania which had carried stock prices well beyond valuations fixed by earning capacity, present or in the immediate future. In consequence, the country is flooded with suggestions, legislative and economic, which are to take the banks out of the stock market. Legislative inquiry into the stock market is in prospect and probably some legislation may be evolved. The close relation between the banks and speculation, therefore, deserves examination in this treatise from two standpoints: (1) the relation of speculation to the unit bank system and (2) its probable relation to a branch banking system.

To clarify the position of the banks, it is neces-

sary to discuss, at least fragmentarily and rather briefly, the entire problem of speculation.

Under an industrial organization such as exists in modern times, when no one person can own a railroad, an industrial enterprise or a public utility, the issuance of security and dividing the property by shares represented by stocks is an essential attribute of financing industrial enterprises. Moreover, a market where these shares may be bought and sold also has a legitimate place. There can be no doubt that the various stock markets in the cities of the United States, which in a similar way are market places for stock as is the New York Stock Exchange, render a legitimate service to the financial community.

However, when that is said it by no means follows that the legitimate services of such a market may not be illegitimately used. It is to the interests of the brokers on the exchange that their customers buy not only what they can pay for, but in much larger amounts, because the commission on a larger order, is of course, greater. It is, moreover, in the interests of the brokers that these customers should not keep a stock once bought, but should sell it and buy again. In other words, it is to the interest of the broker that the market be irregular in order to arouse cupidity for gains in quick turnovers on large amounts of stock. Their market letters advise their customers to "buy on the recessions and sell on the bulges." The irregularity of the market is an asset to brokers and enables them to draw into the speculative world a vast public who

will risk their savings for further gain through speculation.

In this process of drawing in the public and whetting their appetite to buy in amounts larger than their funds permit, the broker is aided by brokers' loans, which are bank loans made on their own accounts or on account of corporations and others to brokers as loans on security of the stock which has thus been purchased. In other words, a customer going to a broker with $2,000 to buy security selling at $100 is advised that for $2,000 he can only buy twenty such shares. The broker will urge him to buy a hundred shares worth $10,000 on which the customer will pay a margin of $2,000 and will deposit the purchased stock as security for a broker's loan of $8,000.

In addition to the exchanges thus catering to the speculative instincts of the public, the financial districts of our large cities are filled with offices and organizations whose business it is to sell so-called unlisted securities, securities not listed on exchanges but usually financed for corporations by banks or investment houses. Here again the customer is sought out and is frequently urged to buy securities far beyond his ability to pay and is given as incentive the probability of increase in value. In this case, as well as in the loans made on the stock exchange, so-called brokers' loans enter into the transaction and the connection between the banks and speculation is as clear here as it is on the stock exchanges.

We need transgress here only for a moment to show a connection between speculation of this type

and business activity. It seems hardly necessary to show that when A buys shares in industrial corporations for $100 and sells to B for $110, that the wealth of the country has not increased by $10, that the industrial corporation is the same as it was before. As a matter of fact, there has been an actual transfer made from the capital wealth of B to the income to A. A believes his $100 has earned him $10 which however has come from the capital savings of B. If C then buys from B at $120, giving B a profit of $10, there has been transferred from capital earnings a total of $20. As this process goes on, the consumption of the country is speeded up in the belief of every speculator that he has made money which in reality has come either from his own or some one else's capital account. In other words, as the speculative increases in prices of securities permeates the country, production and consumption are speeded up beyond the earning capacity of the country and, though the producer and distributor are entirely guiltless of this new method of overproduction, they, in common with the speculator, become the victims of the system when it breaks down and when credit extension is unable further to cover the capital depletions.

The grower of cotton, the spinner of yarn, the weaver of silk may have been entirely innocent or even ignorant of the speculative mania which permeated the stock markets of the country, but the crash in securities suddenly showed that the country must restrict consumption to come within actual incomes, incomes which had radically shrunk from the speculative income before the break in the

stock market. The laborer and the industrialist are, therefore, affected by stock market activity, and it is to their interest that stock securities be stabilized in the same way as industry has attempted to stabilize its activities since the war. Moreover, it may not be amiss to point out here that the stock market is not necessarily the market place of the large financiers and speculators only, and to be ignored by the general public. The war has taught the American people as a whole the method of savings by investment in industries and in public utilities. Moreover, a great many large corporations encourage their employees to buy stock in the enterprise in which they are employed, and amicable relations between labor and industry are often based upon ownership of large blocks of the industries' stocks by wage earners. Corporations have published from time to time, with considerable pride, the large amount of stock held by their employees, and in some instances the stock of employees has representation on the board of directors. The stock market, therefore, has economic consequences of a public nature and today may legitimately be classified as a public institution in a much greater sense than any public utility. If the banks, which are regarded as public institutions, are subjected to examinations by public officials and to restrictions by legal enactments, and if these banks contribute to a situation in the stock market that tends to unsettle business activities and to diminish public confidence in securities, then the relation of the two certainly becomes the subject of legitimate public inquiry.

The problem of brokers' loans had been upper-

most in the minds of public men during the rising market of security values in 1929. The Federal Reserve Board on several occasions directly, and frequently by indirection, warned the public and the banks of what they considered a menace in the rising brokers' loans. Important bank officials repeatedly pointed out the direct contribution made by banks, through brokers' loans, in stimulating speculative activities. The Federal Reserve Bank of New York has attempted so to adjust its discount rates as to continue to make money easy for general business activity and to attempt to restrict it for brokers' loans. It is not meant to show here that these brokers' loans necessarily were a danger to the banks nor is it meant to point out here that the course of the Federal Reserve Board was entirely without blame. What we are attempting to show here is the close connection between speculation and the brokers' loans and that this speculation could not be carried on without the direct assistance of the banks.

To be sure, the method of making brokers' loans upon a safe margin of the securities and a prompt liquidation of these securities on the stock market, should reduced values fail to bring forth prompt covering of margins, made these brokers' loans a safe investment. The drastic reduction in values in the stock market in November, 1929, did not bring to light any loss to the banks in brokers' loans. Only such banks as loaned directly to clients instead of to brokers on securities of stocks, and then found that in the rapidity of the declines they were unable to liquidate fast enough to save their loans, found

themselves with losses or frozen stock securities. Brokers' loans were a profitable investment to the banks because during the period of the spring, summer and early fall of 1929, interest on brokers' loans brought between 6 and 15 per cent, a figure well above the market rate of interest.

We have here an inducement for bankers to lend their surplus funds to the stock market on brokers' loans because of their absolute security and high interest rates. The decentralized system of banking, in which every unit banker looks out for himself and in which there is no unifying policy, not only makes it profitable that each banker should take advantage of this situation, but there is no incentive for the banker not to take advantage of it. Those who are members of the Federal Reserve System are able to discount their industrial paper with the Federal Reserve System and in turn use these funds for brokers' loans.

It should here be pointed out that brokers' loans are liquid only because of transactions among the banks themselves. They do not represent self-liquidating securities.[1] They are, in fact, similar to second and third mortgages since they are predicated on property of industries and utilities that have also outstanding bonds and preferred stocks. When a bank advances a broker's loan it in effect makes a loan on a second or third mortgage in the industry. Because of the activity of the stock market these loans do not become frozen; they pass from one bank to another as buyer and seller exchange stocks.

[1] Cf. "Deterioration of the American Bank Portfolio," E. C. Harwood, *Annalist*, August 2, 1929.

The situation has elements of danger. It is not inconceivable that these brokers' loans may become as much frozen assets as did the excessive land loans in the Middle West or in Florida.

The 1929 stock deflation happily was unaccompanied by a money stringency. The business depression in 1907 was distinctly of that type and the Federal Reserve System was designed to prevent a recurrence. There is no doubt that the Federal Reserve System during the week of October 30, at the height of the panic, saved the brokers' loan situation and the liquidity of many banks, when the New York banks increased brokers' loans by a billion dollars, while out-of-town banks and the "account for others" suddenly withdrew over 2 billion dollars from the money market. In any event the excessive use of brokers' loans represents a weakened bank portfolio. It is further weakened by the fact that the true condition of the exchange of stocks is concealed by the shifting of brokers' loans from bank to bank.

If we assumed a condition whereby there was no sale for the stocks or there was a tightening of loans, there is every danger that these loans may become frozen bank assets in precisely the same way that mortgages become frozen assets. It is on this principle, the non-liquidity of brokers' loans, that the Federal Reserve System does not discount bank loans made on stocks as security, but there are no means of preventing the banks from taking their own money or the money secured by the discounting of their industrial paper and lending it on stocks. The situation was aggravated by the fact that 30,000

banks in the United States, acting for themselves and each one considering its own interests, rushed their funds to the stock market, during 1929, where the investment seemed safe and the interest high. The connection between our disorganized, decentralized banking system and speculation is absolutely clear and it is doubtful whether any legislation can be placed upon the statute books which could prevent the recurrence of the conditions witnessed between 1925 and 1929.

Especially is this true because there is a legitimate use for brokers' loans unassociated with speculation. A corporation floating a new issue frequently finds it expensive and time consuming to wait until the security is sold before proceeding with a proposed development and hence will turn the securities over to a banking house who will advance the funds to the corporation pending sales. A broker's loan in this sense fills an economic need.

The problem, then, is to restrict brokers' loans to legitimate economic needs. It is improbable that this can be accomplished by any legal enactment dealing with funds of some 30,000 banks, when the stock exchange becomes an economic magnet by its high call money rates.

If we assume the existence of a branch banking system in the United States, in which the 30,000 banks are reduced in number and in which the banking services of the country become centralized in larger institutions—institutions that will be directly connected with industrial productivity throughout the entire country as well as with the stock market —the chance of inflated speculative activity of the

stock market may be greatly diminished. Through the more scientific use of the discount rates and because of the economic and social responsibilities of the larger banks, loans to brokers will be checked once they begin to reach dangerous proportions.

It is not improbable that the branch banking system will reorganize investment banking; will, in fact, be a substitute for the present waste in security selling. The bank in every community is the logical place from which prospective investors seek advice; it is in close touch with savings and capital coming to the community and seeking investment. That branch banks will have opportunity to dispose of securities is probably a chief attraction to central institutions for their development. It is not improbable that the success and popularity of the chain banking system largely rests on the opportunity to connect the investing public with the investment securities underwritten by the bank.

There is some danger in converting the branch manager into a stock salesman, but there is also every hope that through the close connection of the central bank to the investing public the responsibility of the bank to maintain a reasonable level for securities will be tremendously increased. There will be encouragement to purchase for investment and discouragement to purchase for speculation. In other words, it is not improbable that by branch banking the present financial machinery, which finds a self-interest in so manipulating securities that they will fluctuate and be bullish, will be changed into machinery that will find the bank's interest advanced by maintaining a stable level of

prices. This control can best be exerted by automatically adjusting brokers' loans to genuine stock values and protecting genuine investors.

It is to be noted that neither in England, in France nor in Germany, all of them being highly industrialized states, does the speculative mania so dominate financial affairs as has been repeatedly the case in the United States. To be sure, even in these countries speculation at times inflates business activity and it is also true that the security market in New York has drawn heavily on European funds, but it is significant that the European exchanges were affected only to a minor degree. Centralized banking facilities in the United States does not mean a money trust—it means a more scientific use of credit. Such scientific use is made virtually impossible by the decentralized banking system.

It is not here proposed to argue that branch banking in its ideal form will necessarily obviate the dangers accompanying the successive speculative manias that deluge the country and disrupt business activity. It is, however, within the facts that in the present scheme of things the banker and the broker gain by a speculative mania. As the speculator turns the card, he deposits a chip for the broker and one for the banker; to the broker his commission, to the banker his call rates. Both gain, irrespective of the speculator's gain or loss. It is to the economic advantage of both groups to feed the cupidity of the speculator and to cater to the speculative appetite. At least the banker should be removed from his share in this periodic disruption of business activity.

Just as producers and distributors have attempted

to stabilize business activity and the basis of more scientific stockholding, so finance can assist the stabilizing process by a more scientific use of credit. Branch banking will not only centralize finance, but will also centralize social and economic responsibility.

In 1907 the country suffered a severe business depression resulting from improper distribution of credit and money; it was remedied by the creation of the Federal Reserve System. In 1920 the country again faced widespread industrial depression resulting from inflation of commodity prices and accumulation of commodity stocks; it was remedied by reorganizing business on the "hand to mouth" buying principle. The depression in 1929 was initiated by inflation of security values; more centralized responsibility of banks in making direct loans and in protecting investments of their clients will go far towards preventing a runaway brokers' loan expansion and a recurrence of the speculative mania. Branch banking, therefore, is an important step towards stabilizing business activities.

## CHAPTER VIII

### Branch Banking in the United Kingdom

BRANCH banking in England developed almost simultaneously with the banking system itself. The Bank of England was empowered to establish branch banks in 1826. A year before that, in 1825, there were as many as 554 private banks in England which already had opened 681 branches. A series of disastrous experiences resulting from the overissuance of notes during the times of stress preceded the act of 1844, establishing the modern banking system in England by which the Bank of England emerged as the only note-issuing bank and as a bankers' bank.

From that point on we have an era of concentration and amalgamation of the banking systems in England. By 1900 the 554 banks had been reduced to 77 joint stock banks having 3,757 branches; by 1913 these banks had again shrunk to 43 having 5,797 branches; by 1925 this number had again decreased to 16 with over 8,081 branches. A hundred years ago banking in England was conducted by individuals and by groups of individuals in the neighborhood in which they lived, in a manner which conformed to local banking ideas and prejudices and had no regard whatever for the national banking position. The interests of the banks rarely extended beyond the local community and was ad-

ministered by local business men in accordance with their understanding of local needs.

The situation at that time was not far different from the present banking situation in the United States. Today the English banking system is in the hands of large companies; operating with expert knowledge of the business interests of the Empire; working along lines of well-tried practice which are noted for soundness and conservativeness; and establishing branch banks in adequate, if not excessive, numbers in all parts of the land. There has not been an important bank failure since 1890, notwithstanding that the banking system was called on, in 1914, to withstand a trial of unusual severity. When we contrast this record with some 5,000 bank failures in the United States during the past ten years, the need for an inquiry into the English banking system and a comparison with the United States system becomes almost imperative if the weaknesses in the American banking system are to be revealed. Moreover, the possible consequences of amalgamation and branch bank extension in the United States can to a great extent be foretold by studying the effects of these movements on English banking.

We have already pointed out the large number of recent bank mergers in metropolitan cities of the United States that accompanied industrial centralization in production and distribution. The amalgamations that took place in England during the past hundred years were of precisely the same nature and were accelerated in the early years of the World War when the banks realized that only larger institutions would be able to continue the financial

supremacy of the English money market. The consolidations differed from the recent American consolidations in that the English banks when merging took over large numbers of private banks and converted them into branch banks or bank offices and when merging with the larger banks already in possession of branch banks these new banks were added to the system and consolidated with it.

In the United States, on the other hand, the mergers made for larger metropolitan institutions and left the large number of unit banks throughout the country untouched. In fact, the consolidations were made necessary because business was shifting from the smaller banks to the metropolitan centers necessitating larger banks there. The unit banks lost business which went to the larger cities, which in turn strengthened their position by consolidation, but they were prevented, because of the legal restrictions on branch banking, from coming to the assistance of the country banks.

The consequences of English bank amalgamations, therefore, differ from similar amalgamations in the United States though to some extent these amalgamations presage certain consequences to be expected should branch banking in the United States be permitted. English bank amalgamations are, therefore, not to be confused with similar movements here, but are direct forerunners of probable branch bank developments in the United States and from that standpoint deserve further study.

The most striking consequence of English bank amalgamations was the virtual disappearance of the independent private bank. Even the 16 banks with

their 8,081 branches do not fully tell the story of the concentration of banking business that has taken place. Thus of these 8,081 branches, 7,852 branches are controlled by the so-called Big Five: Barclay's with 1,950 branches, Lloyds with 1,750 branches, Midland with 1,960 branches, National Provincial with 1,208 branches, and Westminster with 984 branches. Moreover, in addition to these branches in England and Wales, these banks are represented by a string of banks flung over all parts of the British Empire and in other countries throughout the world.

The continued narrowing of the banking interests to fewer and fewer institutions caused some alarm in Great Britain and was responsible for the appointment by the Government, in 1918, of the Treasury Committee on Bank Amalgamations to inquire into the possible existence of a money trust prejudicial to the commercial interests of the country. Reference to the report of this committee has already been made (see Chapter II). It may here be said again that in the main the committee found only minor matters that needed legislation to safeguard industries from the consequences of a centralized banking. The committee found little that was dangerous to British finance and industry and much that was praiseworthy. Incidentally, it may be pertinent to point out what will be discussed more fully later, that it now seems probable that further bank amalgamation in England will be checked, not by law, but by the uneconomic nature of additional amalgamations; that, in fact, the banks have now grown so unwieldy that earnings have

been reduced as the number of branch banks increased. It is, therefore, not improbable to expect that in the United States there will be economic and administrative limits to the number of branch banks within a system even if the law should not limit them.

But though a system of branch banks may reach a point where additional units will exhibit the well-known law of diminishing returns, this in no wise nullifies the conclusion that branch banks drive out unit banks. In spite of the comfort that solicitous friends of unit bankers may wish to extend to them, hoping that the good ones will survive, the probabilities are that time will see the unit banker in the United States as thoroughly eliminated from the banking field as he is today in England. The process need not be painful to the unit banks and need not be accompanied by loss to them in either money or prestige. The change may, in fact, work to the profit of existing unit banks. Certainly a friendly national banking department will safeguard the unit bank's interests to the fullest extent and will in the future, as it has in the past, resist the encroachment of outside banking interests to the detriment of existing institutions. In other words, we will probably go through the same stages as in England except that there will be developed no new banks to compete with existing banks, that, in fact, existing banks will make up the units in the new branch banking systems.

Another result of the amalgamations of banks in England, which caused public attention to be called to it, was the lessened amount of capital compared

with deposits that followed these amalgamations. The amount of capital invested in a bank forms a safeguard to depositors, and protection to depositors demands that the ratio of capital to deposits remain fairly high. The interest of the stockholders, however, is promoted by lowered capitalization which enables the declaration of larger profits and hence acts as an incentive to lower capitalization when bank mergers take place. In England, these larger dividends, over a period of years, served to give prestige to the institution concerned and made for quotations of higher shares, which in turn enabled the banks to continue to purchase additional branch banks. In many cases amalgamations were sought which definitely allowed for a reduction of capital and in turn left a sufficient amount for future expansion. Thus the London and Westminster Bank had been prevented from earlier amalgamation because its capital was too large and, therefore, its dividend too low, resulting in low market quotation. It finally amalgamated with a rival whose deposits were higher and capital lower and hence was in a position to dictate the terms of amalgamation which in this case resulted in absorption.

On the other hand, the absorption in 1914 by the London City and Midland Bank of the Metropolitan Bank enabled the Midland Bank to make a capital reduction of £267,856. Between 1914 and 1924 inclusive, 78 amalgamations took place which wiped out £3,653,351 and created new capitalization in the merged banks of £3,200,457, indicating a net loss in capital of £452,894. The Bank Amalgamation Committee appointed in 1918, among other recom-

mendations, suggested legal remedies that would adequately capitalize the banks to carry the deposits. It may not be amiss here to point to the suggestion of Comptroller Pole, that American branch banks be permitted only when accompanied by adequate capitalization.

Though capitalization was low and in many instances was deliberately held at low figures until remedial measures were applied, proportioned bank reserve funds in recent years continued to increase. In a measure the increase in reserves compensated for the decreasing capitalization. Reserve funds increased from £14,000,000 in 1876 to £60,468,814 in 1923 (see Table XIII). The crude figure unaccompanied by deposits, of course, inadequately pictures the additional firmness given to the banks by the larger reserves. The percentage of capital to reserve increased from 42 in 1875 to 62.1 in 1916. It then declined to 60 in 1917, rose to 85 in 1919 and in recent years has been around 80 per cent. The fact that capital increased slowly or not at all makes these figures seem more significant than they really are, especially because larger profits made the increase of reserves easy. It is however obvious that even before the war the reserves showed definite successive increases, not only in percentages but in total amounts. The percentage of both capital and reserves to deposits declined up to 1918 [1] to the low of 5.9 per cent, but in consequence of legislative enactments at that time, has since been rising and now stands at 7.4 per cent. It would, therefore, appear that the economic consequences of amal-

[1] Cf. Syke, *Amalgamation of English Banking*, p. 107.

TABLE XIII

AGGREGATE CAPITAL AND RESERVES OF ENGLISH BANKS

| Year | Paid-up Capital (000 omitted) | Reserve Fund (000 omitted) | Per Cent of Capital to Reserves |
|---|---|---|---|
| 1836[a] | £10,000 | | |
| 1876 | 32,875 | £14,019 | 42.5 |
| 1881 | 35,521 | 17,182 | 48.7 |
| 1886 | 39,838 | 20,534 | 52.5 |
| 1891 | 50,751 | 24,076 | 47.0 |
| 1896 | 54,371 | 28,941 | 53.9 |
| 1901 | 55,236 | 31,010 | 57.5 |
| 1906 | 54,205 | 34,728 | 63.7 |
| 1911 | 56,107 | 34,494 | 62.0 |
| 1916 | 55,623 | 35,804 | 62.1 |
| 1918[b] | 57,346 | 44,522 | 78 |
| 1919 | 60,405 | 51,288 | 85 |
| 1920 | 75,144 | 58,205 | 77 |
| 1921 | 75,803 | 58,165 | 77 |
| 1922 | 77,192 | 58,307 | 76 |
| 1923 | 75,378 | 58,023 | 77 |
| 1924 | 77,517 | 59,957 | 77 |
| 1925 | 78,340 | 62,239 | 79 |
| 1926 | 80,534 | 64,065 | 80 |
| 1927 | 80,643 | 64,744 | 80 |

[a] Figures taken from Syke, *The Amalgamation Movement in England.*

[b] Figures taken and calculated from *The Statist*, British Banking Section, May 12, 1928; p. 832.

gamation of banks for a time were a substitution of reserves for capital and the decrease of both relative to deposits. It made for more efficient use of deposits but endangered the stability of the banks and was subsequently remedied by legislative enactments.

The best measure of the improved banking service

to the community is the record of deposits. In a sense even here the crude figures are misleading since every loan placed at the disposal of a merchant increases the deposits without actually increasing the net deposits. Hence, a true picture of the increasing banking services as given by deposits would necessitate a subtraction from deposits of the amount of advances, which would leave the net deposits. Such net deposits increased from £52,799,000 in 1883 to a peak in 1919 of £906,531,100, and receded to £726,304,100 in 1923.[2] The percentage of advances to gross deposits was at its highest in 1923 at 67.1 per cent and at its lowest in 1916 at 48.7 per cent.

We need not, at this time, go into the problem of business recessions after the war, but in a general way the joint statement of banks reveals that net deposits grew regularly up to 1919 and we may, therefore, assume that the amalgamation of banks in England and the substitution of branch banks for private banks in no way checked the development of legitimate banking services in England, that, in fact, it increased the flow of credit from the banks.

Amalgamation of banks in England reduced the number of independent banks and changed them into branch banks, thus supplementing existing banks with services of former rival institutions, but it was not the only means of increasing the banking services to the community. Besides the conversion of private banks to branch banks, additional branch banks were opened rapidly in all parts of England, at first to serve certain industrial centers, but sub-

[2] Cf. Syke, *Amalgamation of English Banking*, p. 108.

sequently to cover the entire area geographically. The number of branch banks in England alone rapidly increased to over 8,000. Bank offices increased from 1 to 19,921 persons in 1851 to 1 to 4,689 persons in 1923.

English experience has been that the development of branch banks increased banking opportunities as well as diversified banking business and thus greatly stabilized the banks. Losses in one part of the community were met by gains in others. Industrial establishments in one section balanced with diversified banking business in agricultural communities elsewhere. It is true that in some localities there has been an overdevelopment of banks with subsequent needs for contraction. But it must be reemphasized that the system of branch banking in England primarily developed as a consequence of consolidation of independent private banks and only partially by opening of new banks; hence, overlapping banking services were frequently the aftermath of the planless growth of private banks.

In view of the argument advanced that the development of strong central banking systems with wide-flung branch banks would seriously affect the Federal System, it may not be amiss to investigate the effect of the amalgamation of English private banks upon the Bank of England.

It is readily granted at the outset that the situation is not analogous and that the Federal System is in many respects a widely different institution from the Bank of England, yet it is worthy of notice that one of the arguments brought forward against English bank amalgamation was that it would ut-

terly destroy the fiduciary agent of the United Kingdom, the Bank of England. As a matter of fact, as these joint stock banks increased in power and in extent, the Bank of England has increasingly withdrawn from the open banking field until today it has become a bankers' bank exclusively and occupies the hub of the banking system of England. Issuing of notes, once the prerogative of scores of banks throughout England, has gradually been confined to the Bank of England itself. In 1844, 207 private banks and 72 joint stock banks issued a total of £8,631,647. At that time the Bank of England issued £14,000,000. Between then and 1921 the note issue of the private banks has totally disappeared and the Bank of England has increased its note issue to £19,750,000, thereby replacing the 8.6 million pounds sterling issue of the private banks by £5,750,000 issue of the Bank of England.

During this period the gold reserve has been reduced, a fact which probably would have been more significant before the war, and while indicating a more efficient use of gold as a base for circulating media, the prestige of the Bank of England overshadows these reductions. From a cursory examination of the branch banking development it would seem obvious, therefore, that its influence on the Bank of England has been salutary and that it has strengthened and solidified the influence of the central bank as an agent and clearing house for the banking system of the United Kingdom.

Some further attention should be given to the increased safety of the banks in England in consequence of the amalgamation and the development

of branch banking. Private bankers who operate in local spheres uninfluenced by national conditions, unable to appreciate the need of heavy reserves, operated on a totally different bank policy from the centralized joint stock banks which maintained adequate and accurate public accounting, aggressive competition for deposits, disinterestedness in lending policies, sedulously seeking for safety and with facilities to supply services to a varied industry and a widely distributed public. The war demonstrated that a small number of large banks can pool their resources more readily than can a large number of small banks and that the nation's finances can be better mobilized through the branch bank system.

It is entirely conceivable that fundamentally also the private banks in England in their day suffered from the same malady which to a great extent affects the unit banks in the United States, and that is the selection by the banks of investments that are unsound. It is not improbable that the many failures in the early history of England were the consequence of large amounts of frozen assets and unsound banking systems, a condition that today weighs heavily upon the banking system in the United States.

One more point needs to be examined, and that is the relation of profits to branch banking. An examination of the banking system in England over a period of years reveals a curious situation. As amalgamations decreased the number of banks and increased the number of branch banks, gross expenses continued to mount and net profits steadily

declined although gross profits continued to grow.[3] The same condition existed with branch banks scattered over the country and with branch banks in the large metropolitan centers. It had been hoped originally that banks which absorbed others would show increased earning powers as years went on. This has not been the case. The law of diminishing return has, therefore, set the limits for bank growth and amalgamations.

The following explanations have been suggested. First, the small banks were accustomed to keep a small percentage of liquid assets and after amalgamation they were forced to increase these assets in accordance with their new rankings, the increase in liquid assets necessarily reducing earning power. Second, bad and doubtful debts may have been taken over with amalgamations and necessitated their being written off. Third, rates allowed on deposits have been growing and deposits bearing no interest have been diminishing. Fourth, continued depression of investments had eaten into profits. Fifth, there are banks working on much finer rates; therefore, the benefits of large amalgamation or amalgamation which creates large banks revert to the public.

Summarized, the English banking system has paralleled the American banking system only during a brief period when private banks to some extent were as localized as are the American unit banks, and that branch banking in England developed concurrently with bank amalgamations. The process of amalgamation centralized the financial resources of

[3] Cf. *The Statist*, May 12, 1928, p. 832.

the country into a few strong banks, but did not stifle competition. In fact, competition was intensified as these banks sought deposits in all parts of the United Kingdom and in all types of business enterprises. The evidence clearly indicates that the developing branch bank system and amalgamation continued to place before the country larger and larger numbers of bank offices and banking services. Deposits increased steadily and reserves relative to deposits and capital also increased. The banks of the United Kingdom, the Joint Stock Banks, few in number with widely distributed branch banks, have had no failure for almost a quarter of a century and during that period the World War placed upon the banks unparalleled financial stress. In fact, the war period demonstrated not only the stability of the English banks, but their ability, because of their size and their effective power for organization, to mobilize their resources in the interests of the nation. Two adverse developments in the process of amalgamation may be noted here. First, the tendency of undercapitalizing, subsequently remedied by legislation, and secondly, the decreased net earning power of banks as amalgamations increased.

# CHAPTER IX

## Branch Banking in Canada[1]

THE Canadian branch banking system, with due allowance for the differences between the United States and Canada, offers opportunity to contrast the work done by two such different systems as the unit system and the branch system. It is axiomatic that a system must adapt itself to the conditions existing in the country it serves. The one great difference between the United States and Canada is that the Canadian system has had to adapt itself to a financial public no larger than that of metropolitan New York City, yet covering a territory practically as large as the entire United States. There are regions in the United States where analogies with Canada may safely be drawn. Especially is this true of the agricultural regions where the agricultural depression has found little aid from the unit banker, while in other regions contrasts will be pointed out.

Canada has prospered, as a casual glance at the statistics of the country's leading industries reveals. Of course, this industrial progress may have no relation to a particular banking system; yet to the branch banking system may be attributed results

[1] This chapter was written by Henry Hansen, Editor of the Canadian Section of *The Annalist*.

which a unit system, though we do not overlook its advantages, is inherently incapable of duplicating.

A brief review of the history of legislation surrounding the Canadian system is necessary to understand the system's legal development and to distinguish the differences between the banking systems of the United States and Canada.

When the Dominion of Canada was given power to regulate all matters pertaining to banking and currency under the British North America Act, the country already had sufficient banking experience to enable it to choose intelligently a definite legislative policy. At the time of the first bank act, the Act of 1871, there were in Canada 28 banks which were rechartered under this new act. In addition to having experience, Canada was able to observe the operations of the unit system of the United States. At the time, there was dissension among Canadian bankers on the relative merits for Canada of the unit or the branch bank system, but a majority of the bankers felt that the unit system would curtail agricultural credit as well as retard the development of the frontier. The decision finally turned to the branch bank system with the issuance of asset secured bank notes, rather than the issuing of government money or issues based upon specific security, because it was feared that the latter would increase the cost of the bank note issues and would not be adequate for the needs of the country.

The following is a résumé of the original Act of 1871, with the subsequent revisions, taken from the Canada Year Book:

In 1871, the first Dominion Bank Act provided

for a minimum capital of $500,000, the restriction of bank note issue to notes of $4 and upwards, the redemption by banks of their own notes at any of their offices, the limitation of dividends until a reasonably large reserve fund had been accumulated, the holding of Dominion notes to the extent of at least one-third of the cash reserve, the prohibition of a bank lending money on its own stock and the forfeiture of the charter of any bank which left any of its liabilities unpaid; also, in order that the double liability might be effectively enforced, banks were required to transmit certified lists of shareholders to the Minister of Finance. The Act further empowered banks to open branches, agencies and offices in all parts of Canada as well as in foreign countries where branches of Canadian banks would be permitted to operate; also, the issuance of notes to the amount of a bank's paid-up capital. The charters were granted for ten years only, so as to facilitate the contemplated decennial revisions of the Act.

The first revision of the Bank Act took place in 1881. The noteholder was now recognized as prior creditor and the banks were prohibited from issuing notes under $5, while notes of higher denominations were to be multiples of this sum. Dominion notes were to constitute not less than 40 per cent of a bank's cash reserve, and banks were upon request to pay in Dominion notes sums not exceeding $50.

At the second revision of the Bank Act in 1891, the chief change was the establishment of the bank note circulation fund, founded as a consequence of the losses to which the noteholders of insolvent

banks were still subjected through being unable to turn their notes into cash. It was provided that bank notes should bear interest from the day of suspension of the bank until the date when their redemption was undertaken by the liquidator. If this was not done within two months, the Minister of Finance was authorized to redeem them out of the bank note circulation redemption fund. Such expenditure, if not made good out of the assets of the failed bank, was to be financed by contributions from the other banks pro rata to circulation. It was also provided that the paid-up capital must be equal to $250,000 before the bank could start business.

At the third regular revision of the Bank Act, in 1901, the Canadian Bankers' Association was given authority to appoint an inspector to supervise the bank note circulation and see that no bank issued circulation in excess of its paid-up capital. The revision also permitted one bank to sell its assets to another; also, more detailed monthly returns were required.

In 1908, after the financial crisis of 1907, provision was made for emergency circulation during the crop-moving season from October to January, during which banks were allowed to issue excess circulation up to 15 per cent of their combined paid-up capital and reserve, or rest, fund, this emergency to be taxed at the rate of 5 per cent per annum. In 1912, the period during which emergency circulation might be issued was extended to the six months from September to February inclusive.

At the fourth revision, which took place in 1913, the Bank Act was amended by providing for the

establishment of central gold reserves in which banks might deposit gold or Dominion notes, issuing additional notes of their own against such deposit. A shareholders' audit was also provided for. As a consequence of the war, the provision for emergency circulation was extended to cover the whole year in 1914, while banks were authorized to make payments in their own notes instead of in gold or Dominion notes.

The fifth revision, of 1923, resulted in numerous important changes. The qualifications of provisional directors were redefined, while provision was made for keeping records of attendance at directors' meetings and bringing them to the notice of shareholders. Annual and special statements were given further attention and more complete returns were required from the banks, particularly in cases where operations other than banking were carried on. Detailed provisions were added regarding a shareholders' audit of the affairs of the banks, while the personal liability of directors in case of distribution of profits in excess of legal limits was fixed. Regulations regarding loans were amended and annual returns to the Minister regarding real and immovable property were required. Registration of security for loans was provided for; monthly and special returns were to be made when called for by the Minister; certain loans were prohibited; and the punishment of directors and other bank officials making false statements was provided for.

An important phase of Canadian banking history has been the reduction in the number of chartered

banks, until today there are only ten left.[2] Table XIV shows the total assets as well as the principal and total liabilities of each of the chartered banks of Canada, December 31, 1928.[3]

The series of amalgamations which have taken place have been partly responsible for the reduction in the number of banks. Bank mergers have not been characteristic of Canada only, but the adoption of branch banking made unification of the independent banks inevitable. During the period 1881 to 1901, the number of chartered banks remained about the same, there were 36 in 1881 and 1891, and 34 in 1901, but since that time the number has gradually been reduced so that today but ten banks remain.

Table XV shows the amalgamation of chartered banks in Canada since 1867.[4]

Another factor in the reduction in the number of banks has been bank insolvencies with consequent suspensions. Some of the amalgamations, in fact, were the result of banks approaching an insolvent condition and are included under amalgamations with larger banks as the best way to liquidate the bank and to augment the banking prestige.

[2] Besides the ten large banks in Canada, a new bank has opened but a short time ago, known as Barclay's Bank. Most of the bank's business has been with other banks and it has done but little business with the public. At present it has no branches. According to the September Bank Statement it had total assets of $3,614,901, with deposits by the public in Canada at $186,058. Deposits elsewhere on September 30 were $1,715,760. Notes in circulation amounted to $43,800, current loans $53,179, and investments in Dominion and Provincial Government securities $151,601.

[3] Canada Year Book, 1929.

[4] *Ibid.*

TABLE XIV

| | Total Assets | Capital Paid up | Reserves | Notes in Circulation | Total Liabilities |
|---|---|---|---|---|---|
| Bank of Montreal | $896,569,881 | $29,916,700 | $30,916,700 | $46,722,136 | $893,004,230 |
| Bank of Nova Scotia | 279,813,234 | 10,000,000 | 20,000,000 | 16,098,054 | 278,588,340 |
| Bank of Toronto | 133,620,318 | 5,902,625 | 7,902,625 | 8,972,073 | 132,188,824 |
| Banque Provinciale du Canada | 55,313,125 | 4,000,000 | 1,500,000 | 4,399,126 | 54,877,050 |
| Canadian Bank of Commerce | 727,969,231 | 24,823,400 | 24,823,400 | 34,848,050 | 726,481,591 |
| Royal Bank of Canada | 917,166,975 | 30,000,000 | 30,000,000 | 42,693,953 | 914,099,482 |
| Dominion Bank | 152,805,147 | 6,000,000 | 8,000,000 | 8,207,237 | 152,532,860 |
| Banque Canadienne Nationale | 151,975,270 | 5,500,000 | 5,500,000 | 13,046,069 | 150,975,404 |
| Imperial Bank of Canada | 147,190,675 | 7,000,000 | 8,000,000 | 10,373,900 | 145,756 330 |
| Weyburn Security Bank | 7,276,858 | 524,560 | 250,000 | 726,087 | 7,222,935 |

Table XVI shows the insolvencies that have taken place in Canada since 1867.[5]

During the period 1920-1928 but one bank failed in Canada, the Home Bank, and this primarily due to inefficient management. This is in marked contrast with the large number of failures in the United States during the same period. The failure of the Home Bank, with a capital of $1,960,591 and liabilities of $24,889,049, contrasts with 4,513 bank failures in the United States with a total capital of $196,000,000 and deposits of $1,350,603,000. The bank failures in the United States occurred mostly in agricultural regions, while the agricultural regions of Canada remained immune from the bank failure epidemic of the Northwest.

Several banks in Canada, other than the Home Bank, did feel the pinch of hard times from 1920 to 1924. Such as approached a condition of insolvency took refuge in amalgamation with a more powerful institution. In Canada the branch bank system offered attractions to powerful Eastern banks who were looking for outlets in the agricultural West and the locality or business assets compensated for the non-liquidity of the bank. Thus in many cases the amalgamation worked to the benefit of the public and to the benefit of the absorbing bank. The following extract from *The Statist* well illustrates the trying period through which Canadian banks passed during these years:[6]

"Hardly since Confederation in 1867 has there been a period of greater trial to Canadian bankers than in the

[5] *Ibid.*
[6] *The Statist*, November 8, 1924, p. 674.

## TABLE XV

### Bank Absorptions in Canada Since 1867[a]

| Purchasing Bank | Bank Absorbed | Date[b] |
|---|---|---|
| Bank of Montreal | Exchange Bank, Yarmouth, N. S. | Aug. 13, 1903 |
| | People's Bank of Hamilton, N. S. | June 27, 1905 |
| | Ontario Bank | Oct. 13, 1906 |
| | People's Bank of New Brunswick | Apr. 15, 1907 |
| | Bank of British North America | Oct. 12, 1918 |
| | Merchants Bank | Mar. 20, 1922 |
| | Molsons Bank | Jan. 20, 1925 |
| Canadian Bank of Commerce | Gore Bank | May 19, 1870 |
| | Bank of British Columbia | Dec. 31, 1900 |
| | Halifax Banking Co | May 30, 1903 |
| | Merchants Bank of P. E. I. | May 31, 1906 |
| | Eastern Townships Bank | Feb. 29, 1912 |
| | Bank of Hamilton | Dec. 31, 1923 |
| | Standard Bank of Canada | Nov. 3, 1928 |
| Bank of Nova Scotia | Union Bank of P. E. I. | Oct. 1, 1883 |
| | Bank of New Brunswick | Feb. 15, 1913 |
| | The Metropolitan Bank | Nov. 14, 1914 |
| | The Bank of Ottawa | Apr. 30, 1919 |
| Royal Bank of Canada | Union Bank of Halifax | Nov. 1, 1910 |
| | Traders Bank of Canada | Sept. 3, 1912 |
| | Quebec Bank | Jan. 2, 1917 |
| | Northern Crown Bank | July 2, 1918 |
| | Union Bank of Canada | Aug. 31, 1925 |
| Imperial Bank of Canada | Niagara District Bank | June 21, 1875 |
| Banque d'Hochelaga[c] | Banque Nationale | Apr. 30, 1924 |
| Bank of New Brunswick | Summerside Bank | Sept. 12, 1901 |
| Merchants Banks of Canada | Merchants Bank | Feb. 22, 1868 |
| | Commercial Bank of Canada | June 1, 1868 |
| Union Bank of Halifax | Commercial Bank of Windsor | Oct. 31, 1902 |
| Northern Crown Bank | The Northern Bank | July 2, 1908 |
| | Crown Bank of Canada | July 2, 1908 |
| Union Bank of Canada | United Empire Bank | Mar. 31, 1911 |
| Home Bank of Canada | La Banque Internationale du Canada | Apr. 15, 1913 |
| Standard Bank of Canada | Western Bank of Canada | Feb. 13, 1909 |
| | Sterling Bank of Canada | Dec. 31, 1924 |

[a] The purchasing banks named in the latter part of the table are no longer in business.

[b] Dates given since 1900 are those of the Orders in Council authorizing the absorption.

[c] The Banque d'Hochelaga after absorbing the Banque Nationale adopted the name Banque Canadienne Nationale.

## TABLE XVI

### Canadian Bank Insolvencies Since 1867

| Name | Date of Suspension | Paid up Capital | Reserve Fund | Liabilities | Assets | Paid (in p. c.) to | |
|---|---|---|---|---|---|---|---|
| | | | | | | Note-holders | De-positors |
| Commercial Bank of N. B. | 1868 | $ 600,000 | ..... | $ 671,420 | $ 1,222,454 | 100 | 100 |
| Bank of Acadia[b] | Apr., 1873 | 100,000 | ..... | 106,914 | 213,346 | ..... | ..... |
| Metropolitan Bank | Oct., 1876 | 800,170 | ..... | 293,379 | 779,225 | 100 | 100 |
| Mechanics' Bank | May, 1879 | 194,794 | ..... | 745,238 | 721,155 | 57½ | 57½ |
| Bank of Liverpool | Oct., 1879 | 370,548 | ..... | 136,480 | 207,877 | 100 | 96⁶/₁₇ |
| Consol. Bank of Canada | Aug., 1879 | 2,080,920 | ..... | 1,794,249 | 3,077,249 | 100 | 100 |
| Stadacona Bank | July, 1879 | 991,890 | ..... | 341,500 | 1,355,675 | 100 | 100 |
| Bank of Prince Ed. Island | Nov., 28, 1881 | 120,000 | $ 45,000 | 1,108,000 | 953,244 | 59½ | 59½ |
| Exchange Bank of Canada | Sept., 1883 | 500,000 | 300,000 | 2,868,884 | 3,779,493 | 100 | 66⅔ |
| Maritime Bank of Dom. of Canada | Mar., 1887 | 321,900 | 60,000 | 1,409,482 | 1,825,993 | 100 | 10⅔ |
| Pictou Bank | Sept., 1887 | 200,000 | ..... | 74,364 | 277,017 | 100 | 100 |
| Bank of London in Canada | Aug., 1887 | 241,101 | 50,000 | 1,031,280 | 1,310,675 | 100 | 100 |
| Central Bank of Canada | Nov., 1887 | 500,000 | 45,000 | 2,631,378 | 3,231,518 | 100 | 99⅔ |
| Federal Bank | Jan., 1888 | 1,250,000 | 150,000 | 3,449,499 | 4,869,113 | 100 | 100 |
| Com'l Bank of Manitoba | June 30, 1893 | 552,650 | 50,000 | 1,341,251 | 1,951,151 | 100 | 100 |
| Banque du Peuple | July 15, 1895 | 1,200,000 | 600,000 | 7,761,209 | 9,533,537 | 100 | 75¼ |
| Banque Ville Marie | July 25, 1899 | 479,620 | 10,000 | 1,766,841 | 2,267,516 | 100 | 17½ |
| Bank of Yarmouth | Mar., 6, 1905 | 300,000 | 35,000 | 388,660 | 723,660 | 100 | 100 |
| Ontario Bank | Oct., 13, 1906 | 1,500,000 | 700,000 | 15,272,271 | 15,920,307 | 100 | 100 |
| Sovereign Bank of Canada | Jan., 18, 1908 | 3,000,000 | ..... | 16,174,408 | 19,218,746 | 100 | 100 |
| Banque de St. Jean | Apr., 28, 1908 | 316,386 | 10,000 | 560,781 | 326,118 | 100 | 30⅛ |
| Banque de St. Hyacinthe | Jan., 24, 1908 | 331,235 | 75,000 | 1,172,630 | 1,576,443 | 100 | 100 |
| St. Stephen's Bank | Mar., 10, 1910 | 200,000 | 55,000 | 549,830 | 818,271 | 100 | 100 |
| Farmers Bank | Dec., 19, 1910 | 567,579 | ..... | 1,997,041 | 2,616,683 | 100 | [a] |
| Bank of Vancouver | Dec., 14, 1914 | 445,188 | ..... | 912,137 | 1,532,786 | 100 | [a] |
| Home Bank of Canada | Aug., 17, 1923 | 1,960,591 | 550,000 | 24,889,049 | 27,434,709 | 100 | [a] |

[a] Liquidation incomplete.

[b] This bank was only in existence for 3 months and 26 days. Some of its notes were redeemed on its re-opening for a few days. The Dominion Government received 25 cents on the dollar on several thousand dollars' worth of the notes which it held.

past two years. The decennial revision of the Bank Act last year gave rise to an intense fire of criticism against the whole banking system, the public temper having been peculiarly aroused by the failure of one institution, the Home Bank, and the implication of others in serious difficulties. The first hint of trouble ahead came in 1922, when the Merchants Bank took refuge in amalgamation with the Bank of Montreal. The severe depression in agriculture caused by a long period of deflation and lack of buying power in Europe was primarily responsible for the heavy losses and the large volume of frozen credits that seriously interrupted the smooth working of the banking system. Last year, besides the Home Bank failure, other institutions also got into difficulties, one of which—the Bank of Hamilton—had to amalgamate with the Canadian Bank of Commerce, while two others had to write down their rest accounts."

While branch banking was legally sanctioned by the Act of 1871, the provision for the issuance of notes on paid-up capital rather than on specific security, has been one of the prime factors in the promotion of its development. The benefits of the Canadian system of note issue with its accurate elasticity is as striking as was the deficiency of the United States system before the Federal Reserve System. Under the present Act the banks can meet all seasonal requirements with such ease that there is not the slightest friction. At the same time it has made possible the operation of branches on a minimum of overhead in regions where profits are small.

Table XVII shows the number of branches of chartered banks in Canada, by provinces.[7]

In the branches of Canadian banks the till money

[7] Canada Year Book, 1929.

TABLE XVII

| | 1868 | 1902 | 1905 | 1916 | 1924 | 1925 | 1926 | 1927 | 1928 |
|---|---|---|---|---|---|---|---|---|---|
| Prince Edward Island | ..... | 9 | 10 | 17 | 33 | 31 | 28 | 28 | 28 |
| Nova Scotia | 5 | 89 | 101 | 111 | 141 | 140 | 134 | 138 | 139 |
| New Brunswick | 4 | 35 | 49 | 82 | 124 | 108 | 101 | 103 | 102 |
| Quebec | 12 | 137 | 196 | 784 | 1,138 | 1,100 | 1,072 | 1,105 | 1,135 |
| Ontario | 100 | 349 | 549 | 1,154 | 1,401 | 1,338 | 1,326 | 1,357 | 1,383 |
| Manitoba | ..... | 52 | 95 | 200 | 249 | 233 | 224 | 227 | 231 |
| Saskatchewan | ..... | ..... | ..... | 413 | 452 | 426 | 427 | 436 | 455 |
| Alberta | ..... | 30 | 87 | 247 | 299 | 274 | 269 | 280 | 293 |
| British Columbia | 2 | 46 | 55 | 187 | 200 | 187 | 186 | 193 | 196 |
| Yukon | ..... | ..... | 3 | 3 | 3 | 3 | 3 | 3 | 4 |
| Total | 123 | 747 | 1,145 | 3,198 | 4,040 | 3,840 | 3,770 | 3,870 | 3,966 |

on hand amounts to but a few hundred dollars. A unit bank in the United States could not operate one hour on such a small amount. But this is possible in Canada because of the principle of note issue. The notes of banks are not considered money until they are paid out by the teller and there is no loss of interest on till money, which in the United States amounts to a considerable sum.

This provision has been of great benefit to the entire system and has enabled it to supply banking services to regions where a unit bank could not possibly operate. Many growing regions have not reached the point where financial stabilization is in sight, yet a powerful branch bank can afford to operate with small loss for some years in order to establish itself and grow with the region. The Hudson Bay is such a region. It is developing and may in time become a center of activity but no unit bank could possibly operate there at a profit, yet the Royal Bank of Canada has opened a branch in

Churchill. It will probably take a small loss for some time but in the meantime it is firmly establishing itself and giving the community the benefit of banking facilities.

Supplying adequate banking facilities to agriculture was one important reason for the establishment of the branch system in Canada. Under similar conditions in the United States such regions have been hampered and retarded by the lack of proper banking facilities. The unit system cannot supply to agricultural regions the credit they need and the danger of failure is always more imminent.

Elasticity of currency and the fluid movement of funds are augmented by the chain of branches, making for easier credit. Banks can issue notes up to their paid-up capital and under the provisions in effect today even beyond this. Elastic currency is also secured by the method and the rigidness of rules dealing with the clearing of notes. Since bank notes are not money until paid out, it is to the profit of a bank to rid itself of all notes of other banks and circulate its own. Thus when a teller receives the notes of some other bank he immediately sends these to one of the clearing cities and will only pay out his own. This rapid clearing of notes greatly augments the elasticity of currency and responds to the needs of the country. Each bank withdraws the notes of all other banks and issues its own according to the needs and demands made upon it.

There are 31 clearing cities in Canada where the various banks have established the mechanism for

the clearing of notes and checks. These cities are located throughout the various provinces of Canada but most of the clearing is done through the following cities: Calgary, Edmonton, Hamilton, Montreal, Ottawa, Quebec, Toronto, Vancouver and Winnipeg.

The fluid movement of funds in Canada, as well as the elasticity of currency, has been a great advantage to the country as a whole, especially to the agricultural regions. The movement of funds from East to West is of extreme importance especially when the crops are to be exported or moved to selling centers. Canada has been fortunate in that through its great branch system credit is available at all times, funds move readily from surplus to deficient regions, and that its currency is one of the most delicate systems of its kind. The elasticity of currency in the United States cannot and does not measure up to the Canadian system, credit is not so available and the movement of funds, although facilitated through the Federal Reserve System and correspondent banks, does not work smoothly enough and often causes delays.

There have been cases of complaint on the part of certain groups in Canada that they do not receive an adequate supply of capital or at reasonable rates. Rather than indicating a defect of the system, this exhibits one of the benefits to the country. The Maritime Provinces have had to compete with others with more favorable industrial opportunities and business has declined, and while a local unit bank would buoy this up for some time the end would be disastrous. The more favorably situated

provinces are able to take advantage of the easier credit while credit for less favorable regions becomes tighter. It is not a fault of the system but works as an automatic regulator of credit and prevents over-expansion in territories not suited for some particular industry. The industries of the Maritime Provinces must compete with industries of the other provinces on an equal basis and credit will flow to such centers where the demand is greatest and accompanied with sound industrial prospects.

Not only have Canadian farmers been able to obtain easier credit but rates have been lower than in corresponding regions of the United States. While rates vary and no definite rate which Canadian farmers have to pay can be quoted, the range is approximately from 7 to 10 per cent, while the rate to farmers near the Canadian border in the United States is several per cent higher.

The reason for these lower rates is inherent in the system. It is due to the rapid shifting of funds from the East to the West and back again when not needed. The large number of branches facilitates this movement, and various industries in need of credit at different times are paired off against each other. Again, the great savings in the overhead of a branch in Manitoba compared with a unit bank in Dakota makes for lower operating costs in Canada. If this savings in overhead did not exist many of the branches of Canadian banks could not operate profitably.

Diversification, a word that at present has been assuming more and more significance in the United States, has been carried out in practice in the Ca-

nadian branch banking system. Banks will not tie their assets in any one industry nor one locality. The unit bank in the United States has little choice. It cannot diversify its assets to the extent that a large branch bank can and is compelled to associate its fortune with the industry in its particular locality. If it is in an agricultural region with farmers who are land poor and making no profits, the bank, unless managed with more than average skill, frequently will find its assets frozen. Practically all Canadian banks have branches in the various provinces. Some, especially the Royal Bank, have many foreign branches. If one particular region is depressed and loans cannot be readily met on the part of the borrower, the bank is not forced to close but may have other enterprises which will carry it along. The resulting benefit to bank and community is obvious.

In the past some banks in Canada have frequently had their branches in one region. In the case of the Union Bank this was true, but among the present chartered banks this tendency has practically disappeared. In the case of the Farmers Bank, which had all its assets tied up in a mining venture, the Keeley mine, the failure was reported to be due more to inefficient and dishonest management than to a defect of the system. Such tendencies are more prone to exist in the unit system because a large branch system can attract a higher type of executive. Especially is this true of positions in the head office, where mismanagement is likely to be of greatest damage. The tendency to gamble away assets of a bank has been corrected through the decennial re-

vision of the Bank Act. In the revision of 1913 a stockholders' audit was authorized to reduce the risk of speculation on the part of the management.

The following extract from *The Statist* [8] illustrates the movement of diversification and concentration on the part of Canadian banks:

"The concentration movement in Canadian banking, characteristic especially of the recent years of Canadian banking history, is very closely connected with the difficulties which the credit structure has been called upon to undergo in consequence of the agricultural and industrial depression of the last four years. The last, and perhaps most important, of the amalgamations which have taken place is the acquisition of the Union Bank of Canada by the Royal Bank of Canada. The Union Bank, established as long ago as 1865, has always been closely associated with the westward movement of population and the development of the Prairie provinces. Bound as it was with the prosperity of the agricultural community, the bank was one of the first institutions to feel the reaction of the agricultural depression that marked the years 1922, 1923 and 1924. Its difficulties were aggravated by losses incurred in unauthorized foreign exchange transactions on the part of certain officers, and during 1923 reserves were reduced from $6,000,000 to $1,750,000. . . . In view of the substantially reduced earnings of the bank the directors were faced with the necessity of making a drastic cut in the dividend distribution. Rather than allow such a blow at the credit of the institution, the only alternative course, that of amalgamation with a more powerful institution, was chosen. Both to the Royal Bank of Canada, which is acquiring the Union Bank of Canada, and to the shareholders of the latter institution, the amalgamation

[8] May 30, 1925, p. 1023.

should prove a welcome and profitable transaction. . . . The Royal Bank should benefit materially by the acquisition of a highly developed network of branches throughout the Western Provinces."

One criticism of the branch banking system, that is often advanced, is that not enough interest is taken in the industries of a small community. The proponents of the unit system point to the fact that in small communities the local industry is financed by the local bank. Viewed from the standpoint of the individual, the communal interest of a local bank has many advantages. However, viewed from the general economic interests of the country, it will be granted that bank after bank finances its local industry without any regard to the demands or needs of the nation or the position of the industry from a standpoint other than local. Canadian banks take a wider viewpoint. The manager of a local unit bank has not the facilities at hand or is not so situated as to be in touch with all the factors of a certain industry or view the industry as a whole.

A case in the United States where this local viewpoint was carried to an extreme has been called to the writer's attention. Within a radius of eight miles three towns imitated each other in the establishment of a hosiery mill. The bank of each town financed its own local mill with no regard to the needs of the market or to the demand for this commodity. The consequence was that as soon as a depression hit the industry, two of the factories went bankrupt and the banks found these loans, which amounted to a considerable sum, frozen. Although there are no definite assurances that this

would not happen under a branch banking system, the probabilities are that the loan along such line by any branch would promptly receive the scrutiny and review of the head office, which would be in a position to judge the need of the country for any particular commodity.

It is interesting to note that in Canada the bankers are in close touch with their public and with the state of each particular industry. In part this is because of the small numbers of customers and in part because it is not the custom of any depositor to have more than one account. Even the largest industries can receive a necessary amount of credit from one institution and do not have to apply to several to fill a large loan. There are no restrictions, except those the banks set up for themselves, as to the amount loaned to one person. Even if there were a limit of 10 per cent, it will be seen from Table XIV that this limit would practically meet all requirements made upon a bank.

Personal knowledge of its financial public is an important feature of banking in Canada and partly disproves the allegations that the head office of a bank has no knowledge or interest in a particular community. A prominent Canadian economist, and one who is in a position to know due to his connection with a bank, told the writer that he could find in the head office of this particular bank at least one man who knew in person and his state of affairs any client asking for a loan of $50,000 or over, and that in most cases he could find one man who knew personally anyone in the $10,000 class or over.

The outstanding criticism that can be directed against the system of Canada, as compared with the United States, is that it lacks a central bank and subsequent central bank policy. It has no such agency as the Federal Reserve Bank that can adequately provide a mechanism for the raising of rates and deal with the gold export problem. At present Canada is practically on a limited gold standard because it has no real facilities for dealing with the gold export problem. The banks deal as well as is individually possible with this problem but the question of foreign exchange rates and the money market as a whole is one on which no united front can be presented. The idea of a central bank in Canada offers many complications, especially since this bank would probably be given some note issuing privileges. This, no doubt, would meet with much opposition as the note issuing privilege means considerable profit to the present banks, as well as providing a means of running branches on a minimum of overhead.

Another point in the Canadian system that has been severely criticized is the decline in the ratio of capital and surplus to total liabilities. Table XVIII

TABLE XVIII

RATIO OF CAPITAL AND SURPLUS TO TOTAL LIABILITIES

| | | |
|---|---|---|
| 1885.....57.35 | 1916.....14.16 | 1923.....10.56 |
| 1890.....46.82 | 1917.....12.06 | 1924.....10.09 |
| 1895.....38.76 | 1918.....10.28 | 1925..... 9.55 |
| 1900.....27.36 | 1919..... 9.46 | 1926..... 9.29 |
| 1905.....22.48 | 1920..... 9.06 | 1927..... 9.13 |
| 1910.....17.53 | 1921.....10.29 | 1928..... 8.43 |
| 1915.....16.76 | 1922.....10.78 | |

shows the extent to which this decline has taken place.[9]

It will be remembered that Comptroller Pole, in speaking of branch banking, pointed out that this decline in capital and surplus to liabilities presented a danger and recommended necessary legislation to preclude such development in the United States. In Canada the failure of banks to increase their net worth was even more significant because before 1908 the note issue could not exceed the paid-up capital. However, since 1908 this limitation of the note issue has been removed.

Another criticism that has been directed against the Canadian branch banking system is that it creates a money trust and reduces healthy competition. That competition exists between the various banks in Canada is difficult to prove statistically except by the fact that one will find in a small community several branches of various banks. Banks are particularly eager to obtain the accounts of new industries establishing themselves in Canada, and this is where the greatest competition arises between banks. It is, however, a practice not to persuade customers to switch their accounts.

A further criticism of the system is that the local branch managers fail to take the interest in the community that is said to be characteristic of the manager of a unit bank. The complaint has been made that they are shifted just when they have become acquainted with the needs of the community and that they are not given sufficient authority but must refer too many matters to the head office. This

[9] Canada Year Book, 1929, source for capital and liabilities.

criticism is not so true at present as it was when many new branches were opening. It was more difficult for a bank to choose the proper man when it was expanding so rapidly. Naturally some inefficient men were appointed but these have been removed and it is to the interest of the bank that its local man display interest in his community. The bank realizes this and when a manager has proved his ability he is given more liberty in the making of loans. Once a certain line of credit has been given a customer it remains operative with the local branch without reference to the head office, unless an amount greater than this is needed. Even when matters are taken up with the supervisor of a region, or the head office, the speed with which this is accomplished does not interrupt the smooth working of the system or inconvenience the customer. It may also be said that the local manager of a branch usually takes a better and broader viewpoint of the business situation than the local unit banker, as he has been able to see conditions in different territories.

As to the internal organization of the Canadian banks, it is difficult to generalize. The organizations of the ten banks differ widely. However, taking an individual case, the general organization is as follows: The board of directors is composed of men representing leading forms of businesses and regions of the country. From this group the president is elected, who corresponds to the chairman of the board in the United States. One of the members of the board is the general manager. The secretary of the bank is on the board but has no voting

powers and is as a rule the first assistant general manager. He deals with all of Canada.

Under the first assistant general manager are the assistant managers. These are usually regional and one deals with the foreign business of the bank. Related and responsible to the foreign manager is the foreign credit department, which takes up in the head office all matters pertaining to credit in the various foreign branches. Under the foreign manager are the various supervisors, under whom are the inspectors and finally the local branch manager. The regional manager in Canada and his departments are similarly organized. There is a great deal of cooperation between the various departments and it is often difficult to distinguish where one ends and the other begins.

The authority delegated to the local branch manager differs according to the ability and the personality of the man. If a manager has proven his judgment he is given broader powers. The typical loan upon which the manager of a small branch can pass is $2,500, and it varies in size up to $10,000 for larger branches. The regional supervisor and the regional board of directors, which meets every week, pass on such loans as are beyond the authority of the local manager up to $50,000. In the case of larger loans the supervisor takes up the matter with the head office.

# CHAPTER X

## Branch Banking in California

BRANCH banking development in the United States is necessarily confined to certain states within, what may be called, the branch banking area, that is, only in states of this area which permit banks to establish branch offices outside of the cities of the parent banks. See Table XII.

California—with 63 out of 496 banks of all classes operating 826 branch offices, such offices constituting nearly two-thirds of the total banking offices of the state—is an especially noteworthy example of probable branch bank development. The state is atypical in so far as it is much more thoroughly organized under a branch bank system than any other state in the union. The branch bank in its pure form, or rather in the form in which it is understood in this discussion, exists here. Two branch bank organizations within that state, the Bank of Italy National Trust and Savings Association and the Bank of America of California, operate together over 500 of the 826 branch banks.

The Bank of Italy was founded in 1904 and established its first branches in 1912 by the absorption of the San Mateo Bank. In 1913 it purchased the Park Bank in Los Angeles and from then on, by a

series of absorptions, it attained 291 banks in 165 California cities and towns. Its capital, surplus and profits have increased from $300,000 to $106,253,-

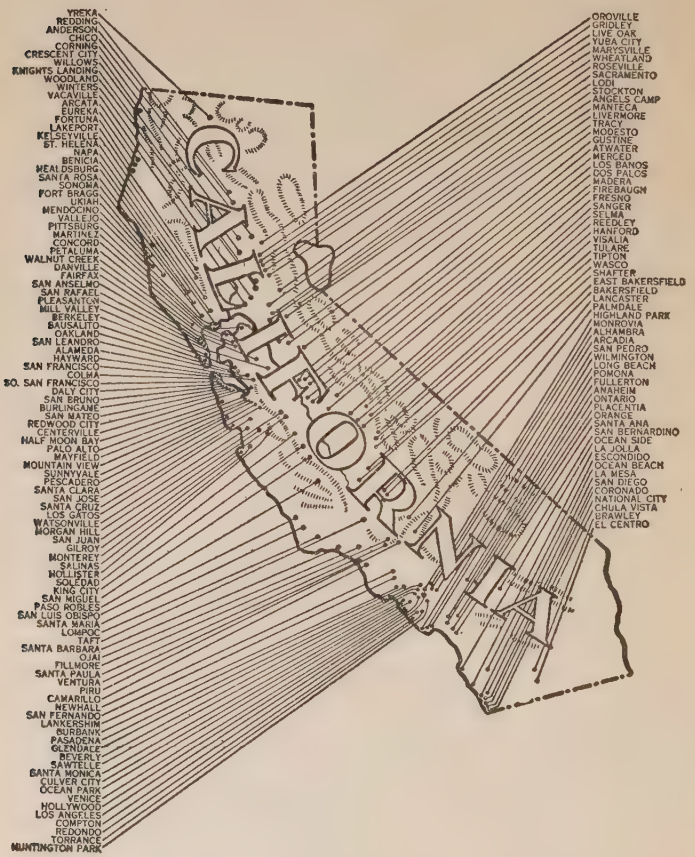



CHART VI.

A BRANCH BANK SYSTEM IN CALIFORNIA WITH 291 BRANCHES.

731.03. It changed from a state to a national bank in 1927, taking advantage of the McFadden Act which permitted the nationalization of state banks

with branches, if these branches were in existence before the enactment of that legislation.

In this connection, the interworkings of chain banking and branch banking may be pointed out. Further additions to the state-wide branch banking system of the Bank of Italy, originally organized under state charters, were, of course, checked as soon as the bank became a member of the national system except as the national bank law permits branch banks within city limits of the parent bank.

The Bank of America of California was organized on December 8, as a merger between the Merchants National Trust and Savings Bank of Los Angeles and the United Security Bank and Trust Company of San Francisco. The new bank took over some fifty offices and branch banks throughout northern, central and southern California. From that time it has added branches throughout the state and by the end of 1929 was reported to have 165 branches. Ownership of the Bank of America, the same as is the case with the Bank of Italy, rests with the Transamerica Corporation, a holding company which announces that although it "will continue to own and acquire large holdings in other banks, controlled and affiliated companies, its real function is to be that of a holding company in the larger program of looking toward ultimate nation wide and world wide branch banking." At present, banks known to be under Transamerica control operate systems with 456 offices in nearly 240 cities in California, 34 offices in five boroughs in Greater New York and 29 offices in Italy. The Transamerica

Corporation announces that it controls the following organizations:

Bank of Italy National Trust and Savings Association
Bankitaly Company of America
Bank of America National Association, New York
Bankamerica-Blair Corporation, subsidiary to Bank of America, New York
Bank of America of California
Corporation of America
Oakland Bank
Banca d'America e d'Italia, Milan, with 30 branches
Bankitaly Mortgage Company
California Joint Stock Land Bank
Pacific National Fire Insurance Company
Bankitaly Agricultural Credit Company

We have here a corporation which owns capital stock of banks situated in various states and having international connections, with capital totaling about $723,724,606 and having total resources of over 2 1/3 billion dollars. Should these organizations be merged in such a way as to make a genuine banking institution rather than a holding company, it would constitute one of the largest banks in the world. The leading spirit under whom these organizations of banking and especially the branch banking system have been organized is A. P. Giannini. Mr. Giannini is quoted as giving these reasons for branch banking:

"In dozens of communities a small bank cannot handle the finances of big manufacturing firms right at hand. They are prevented by the law, which forbids any bank to lend to a single customer more than ten per cent of

its capital and surplus. So these business firms have to make financial arrangements in San Francisco or Los Angeles. . . . I shall put the window of a San Francisco bank in each community I enter, and we can handle any business in any amount.

"Then too, the small bank, as part of our system, will have the advice of our high-salaried executives—advice such as otherwise it couldn't possibly afford. Remember, also, that California has about every kind of climate and product known to man. We have our citrus district, our prune district, our rice district, our bean district, not to mention the areas of grains, garden truck, oil and minerals. Frequently one or more of the crops is a seasonal failure. This is a hard blow to the banks that have financed the growers of that particular section. . . . The resources of our organization will be flexible. We shall be able to shift them about as the demand for money waxes and wanes in various regions. Any localized hard times will make little dent on the system as a whole."

Returning to the workings of the Bank of Italy, which, taken out of the Transamerica organization and by itself, is a genuine branch banking organization covering the state of California (see Chart VI), we find in its operations much that may be expected from a prospective branch banking system that might cover the country in response to permissive legislation. The branch bank connections have enabled the Bank of Italy to distribute its stockholders widely throughout the state of California though, as already indicated, stock has subsequently been exchanged for stock in the Transamerica Corporation. In making purchases of banks throughout the state, efforts were made to continue

to exchange the stock of the Bank of Italy for the stock of the existing institution. It is of further interest that when a unit bank was purchased by the Bank of Italy to be converted into a branch bank, the entire banking organization was taken over; that, in fact, the purchase did not include merely the building and banking assets, but the entire personnel and that this personnel was retained in the home bank or, in some instances, was transferred to adjacent institutions. Even the board of directors, who formerly were the owners of the bank, was retained as an advisory board and frequently this advisory board was augmented by additions from the more prominent business men of the community. The retention of the advisory board, which meets once a month and is paid for the meetings, is regarded by the officers of the Bank of Italy as an important link between the main office and the community. It, of course, also has considerable business-drawing advantage. In many of these operations the Bank of Italy is representative of activities of other branch bank organizations.

The manager, placed in charge of branch banks in California, is, of course, given varying authority with regard to independent action, depending much upon the size of the bank and upon the confidence the main office has in the manager. The main office attempts to have in charge of branches men who may be entrusted with broad if not absolute powers. While the powers are broad, reports of business transactions are uniformly expected to be prompt. In most of the branch banking systems the branch manager is expected to report each day the loans

that are made. These reports are made to the credit department of the bank, giving the necessary data on the loans. The credit department, after dispassionately examining the information, reports to the finance committee which in turn reports to the executive committee. Thus the manager knows that two organizations, unaffected by personalities or bias, will examine the loans that he makes and that the retention of his job and even his promotion depend upon his making loans that will pass the scrutiny of two groups of disinterested experts.

In the case of the Bank of Italy there exists a third organization to scrutinize these loans, independent of either the credit or the finance committee which is a sort of roving group of examiners directly responsible to the head office. These examiners, without notification, drop into a bank, examine its loans, signatures and property and make an independent report direct to the executive committee, reports that are carefully checked with those of the finance committee.

All this seems an excess of caution, and yet caution does not stifle eagerness to seek new business. Through its local manager and his advisory committee, branch headquarters are eager to know of, and extend to, any industry that may develop, credit and services if deserving of banking support. Thus a manager who finds a promising industrial development in the community, but one that is beyond his experience, may call upon the main office for assistance and guidance. The main office will send experts to examine the industry and will advise

both the main office and the local manager as to the bankable security that is back of the industry.

The branch bank organization naturally has a wider view than is possible for a unit bank. Post-war agricultural overdevelopment in California has not been as marked as in many other states. California, as a new state and with a variety of fertile soils, accompanied by a subtropical climate, has been more than any other state the victim of unscrupulous or misguided real estate developments. Following in the footsteps of the real estate promoter usually comes the bank. Hence, it would not appear unreasonable if many banks became over-enthusiastic with the prospect of the soil and climate. The remarkable fact is that both unit and branch banks kept well within reasonable bound when the orgy of agricultural development was at its height. Yet California, though not affected as seriously by the aftermath of deflation, still had its share of distress. It is not improbable that the branch bank system contributed a great deal towards a more balanced bank policy. Land in many sections of California rose to $1,600 to $2,000 an acre. Though in no wise definitely stating a public policy, it was commonly noticed that loans from branch bank organizations usually were made at figures around $200 to $300 per acre, which was more in accordance with the long-time earning trend. It is not meant to imply here that branch banks loaned wisely and unit banks unwisely. As in any other economic situation, there were sheep and goats on both sides. Yet the sounder policies of

branch banks had wider influence and frequently affected the unit banks.

Throughout the agricultural regions of the United States, especially in the Middle West, it is rare to find a banker who is not also an expert on farm management, not only because he lives in an agricultural environment, but also because he is likely to have the bulk of his fortune invested in farm enterprises. This knowledge of farming, however, does not cover a wide range. It may include live stock, grains and corn, something about drainage and a little about fertilization. The simplicity of the problems makes the Midwestern bankers the most expert group of farm managers throughout this area.

But in California the problems are much more complex. Farm production runs from cereals and animal husbandry to summer and winter vegetables and deciduous fruits in great variety. These require special knowledge of a highly scientific character. The problems include irrigation and drainage, fertilization and pruning and a bewildering variety of spraying and marketing subjects. Moreover, there is a great variety of soils with which the farmer must deal even in his small community.

Another point that differentiates California agricultural regions from the Middle West is the amount of the loans. Many of the crops are delayed crops. The original investment in the land is subsequently augmented by the planting of trees which remain immature for several years, during which time they require care and cultivation. Thus it is not infrequent to find a California farmer purchas-

ing land at two or three hundred dollars an acre, expend another hundred dollars for irrigation, several hundred dollars for planting and then spend another hundred dollars annually for the caring of the land for two or more years until bearing time. By that time the outlay per acre may have mounted from two to seven or eight hundred dollars. The large acreage in many of the fruit producing areas demands from the banks considerable skill in appraising the value of the land and improvement, making available adequate funds to the producers, yet preventing these loans from becoming frozen assets of the bank. Expert information, essential even in normal times, is doubly so in times of inflation, but the extent to which it was ignored throughout the Middle West has already been told. The result was a deluge of foreclosures, when prices dropped, in which the farmer lost his farm and the banker frequently lost his bank. In California, however, the epidemic of bank failures was less than in the Middle West because banks had been more prudent with loans and also because many banks could easily fall into the embracing arms of the newly organizing branch banking system. The smaller banks gladly sold out to the branch banking systems that were suddenly gaining ground throughout the state.

Branch bank organizations, however, sought for purchase mostly the stronger banks, nor were they so improvident of the welfare of their own depositors as to incorporate into their own totals the slow loans and forfeited real estate of the selling institutions. One group divorced the depositors' and

stockholders' interest in assets of that character by taking them out of the banks entirely and lodging them with separate corporations. Thereafter whenever necessity required the foreclosure of a mortgage, the auxiliary corporation would purchase the foreclosed property from the bank for cash. By this means the bank is kept free from improper assets and the depositors' interest is not jeopardized. Another branch bank refused to accept such frozen securities when the bank was sold, but left them with the stockholders. Thus if buyer and seller agreed to sell the bank for $250 a share and subsequent examination revealed $75 per share of frozen assets, these assets were turned back to the stockholders and the purchase price was reduced to $175 a share.

The close connection between branch banking and modern business is well illustrated by the arrangement that one branch bank has effected between its branches and a large chain store organization with headquarters in New York. In the absence of a branch bank system, the local manager of the chain store would deposit each day the receipts of that day for which he would then make out a check which was sent to the main office in New York, and there in turn, it would be deposited in the New York bank. The check would then be sent back to California to clear. All in all, it would take between five and eight days for the money or the credit to reach the home office.

Under the arrangement with the branch bank system on the day that the local store in any town deposits the day's receipts in the branch bank, from

that day the chain store organization is credited with interest on that money. In other words, the chain store organization is gaining between eight and ten days' interest by dealing with branch banks. Chain organizations have found it to their advantage to deal with the branch of this state-wide system.

The Bank of Italy, now a national institution and a member of the Federal Reserve System, clears the checks from one branch to another through its own offices and from banks of other branch bank systems or any unit bank, through the Federal Reserve System, the same as would a unit bank. The funds can be transferred from one branch to another by checks just as in unit banks. In fact, because the Bank of Italy covers the whole state of California, it can and does transfer credits from one bank to another in accordance with the needs of the district. Thus the funds would be used at one time to harvest vegetables, then grapes, then apples, then oranges and other citrus fruit in succession as the seasons for the various crops advance. This, of course, is a typical procedure of other branch bank organizations.

Through their branches, the branch bank organization makes loans to farmers as producers, but because of its state-wide contact with production, it also extends its financial interests to marketing problems, and consequently has been directly interested financially in many of the successful California cooperative marketing associations that gather, crate and market fruit for their members, and also in many of the commission houses, whole-

sale dealers and shippers who bring the fruit from the producer to the market. The banks, therefore, have authoritative and first-hand knowledge of the producing and marketing situation of any crop and are able not only to protect their own interests, but also to give valuable counsel to producers and to marketing organizations.

A most admirable illustration of the assistance which branch banking may exert to ease the economic changes brought about in a changing agricultural situation is that of the shifting of cotton growing from Southern California to a more fertile northern district. The state-wide view of a branch bank clearly revealed to its officers that cotton grown in this district was more adapted to the climate and the soil and gave greater returns for each hour of effort and each dollar invested. Such economic disparity usually is self-adjusting though accompanied by painful shifts. The change in this case was accomplished through a judicious loaning policy of the branch bank system, easing and shortening the painful readjustment period.

Branch banks in California have not as yet been accused of stifling competition nor of having created a money trust. The founders of the largest branch bank system have succeeded in widely distributing the capital stock among the population and hence have made it an economic democracy. Though it meets with much criticism, especially from unit bankers who reflect competitive sentiment, it is conceded that the branch bank competition is one of standard banking and backed by sound banking practices and that it renders to California a bank-

ing service which has the confidence of the communities in which it exists. The charge that a branch bank is uninterested in local affairs is disproved here as it is admitted that it keeps in touch with local affairs and, in fact, is aggressively in search of developing institutions that may require banking services, and its managers are as eager for genuine banking business as would be a unit bank organization. On the other hand, the various checks superimposed from above make for caution, conservatism and sound banking practice.

Stifled by the national law, the Bank of Italy National Trust and Savings Association has ceased to grow in number of branch banks as such, but the Bank of America of California has already acquired 165 branches. The two institutions together operate over 456 branches in California and in order to conform with the restrictions of branch banking, they have found common shelter under the holding company known as the Transamerica Corporation, of which mention has already been made.

In 1928 the Bank of Italy had commercial or demand deposits amounting to $207,000,000 contributed by 1,300,000 depositors, representing almost one-fifth of the entire population of California, and had total resources of $765,000,000. In 1928 it paid $7 dividend per share; in 1927, $9.62 a share; in 1926, $17; in 1925, $14.75; in 1924, $13.75; in 1923, $13.25, and in 1922, $12.60.

President A. J. Mount of the Bank of Italy gives the following outline of the basic principles used as guides in the establishment of branch banks:

"In determining upon the establishment of a branch office there is to be considered primarily the matter of public convenience. In California, the law relating to this subject—under the provisions of which state banking systems are administered—specifically sets forth that the promotion of public convenience and advantage is the essential factor.

"Certainly a banking office that is not so situated that it will be of benefit to prospective customers, will have a hard struggle from the outset, and no farseeing banker willingly is going to permit his institution to set up a branch that lacks the ability to be of service.

"Like other constructive undertakings, the selection of a new location requires a careful preliminary survey. In metropolitan areas the initial step is concerned with a division of the city into districts. This is more than an arbitrary geographical separation of units, since it must give weight to trading tendencies, arteries of travel and direction of business development. Here are some of the significant considerations in the determination of a branch location:

1. Area to serve
2. Population
3. Number of present customers in district
4. Number of stockholders in district
5. Number and class of stores
6. Location of other banks
7. Location of chain stores
8. Side of street
9. Transportation facilities
10. Direction of traffic
11. New construction
12. Distance to nearest branch.

"Personal surveys are made by a qualified officer,

whose report is accompanied by a sketch of the tributary business and residential districts under scrutiny. The report deals with all the factors outlined, and also reaches into such special conditions as may have a bearing on the subject. Experience indicates that only the territory that can be actively supervised by the branch manager should be permitted to have weight in reaching a conclusion. Bank service is fairly well standardized, and the business pull exercised in any given instance is usually found to be availability.

"While in general the service of each new branch may logically be expected to expand until it embraces services that are identical with those offered at the larger offices, at the same time desire must be tempered with judgment, and the expansion permitted to flow with the needs and opportunities of the specific location.

"The paramount consideration in the establishment of a branch, of course, is profit. While an occasional loss may be anticipated during the early months of a branch's existence, this should be regarded as an exception and not the rule. Proper care in the original survey and thoughtful consideration of the various elements that sway a decision, will go a long way toward the elimination of costly mistakes in the choice of location.

"Aside from the physical aspects of the situation, the selection of the branch manager and his staff is of prime importance. Those who are to be responsible for the conduct of the new office need not only thorough knowledge of bank routine and institutional policies but also an appreciation of the value of community contacts in the development of business. Only those who have a record as producers should be assigned to branch office positions.

"Before the final decision is reached with respect to

establishment of the new branch, there is in hand a complete picture of actual conditions, together with data relating to economic facts of an essential nature, as well as an understanding with respect to the available personnel and its adequacy."

We have laid considerable stress on the operations of the Bank of Italy because it is the largest branch bank in existence in the United States with a history of twenty-five years of development, and thus affords the best opportunity for study of the probable consequences of branch banking. It is for that reason we must ask the indulgence of the reader in having shifted to so large a degree the discussion from the general to the particular. The operations of the Bank of Italy illustrate the advantages that can be secured with branch banking, and the Transamerica Corporation also illustrates the organization of a holding company of branch banks, one that controls branch banks now within the Reserve System and an additional branch bank organization under the laws of California, as well as banks in other states and countries.

In the state, as a whole, 65 national banks with assets amounting to $246,990,000 have been taken over by state banks since the passage of the McFadden Act. The national banking system has lost three times as many banks in California as in any other state.

The total loss in number of banks from February, 1927 (date of passage of the McFadden Act), to July 6, 1929, was 263, of which the following states contributed most:

| State | Number | Per cent of total |
|---|---|---|
| California | 65 | 24 |
| Oklahoma | 21 | 8 |
| New York | 21 | 8 |
| Pennsylvania | 20 | 7.6 |
| Texas | 13 | 5 |
| New Jersey | 10 | 3.9 |
| Idaho | 10 | 3.9 |

The figures indicate that the state-wide branch banking privileges in California had especial attractions for the national banks and proved to be the magnet which drew them from the national system. They also show that the McFadden Act is not sufficiently liberal in its provisions to retain the national banks in the system when situated in states where branch banking is permitted and presents banking opportunities. The 65 banks had total assets of 247 million dollars, or about 8 per cent of the assets of all seceding banks in the United States. Hence, the State of California accounts for one-fifth of the number of banks that were lost to the national system, though the total assets of these banks were relatively smaller than for the country as a whole. These figures, however, do not fully reveal the story. In the case of the Bank of Italy, we saw the state bank with its branches converted into a national bank and further branch bank development then taken up by a previously state incorporated banking system, the Bank of America of California. The loss to the national banking system, therefore, does not account in full for the pressure for a branch bank system. Many banks, no doubt, joined the national system on the same basis as did the Bank of Italy.

During the period from 1921 to 1928, when 4,513 banks in the United States were suspended, California suspended a total of 27 banks out of 723 in existence in 1920. This makes 3.7 per cent of suspensions of the total number of banks and compares with 15 per cent for suspensions throughout the United States and from 10 to 40 per cent in most of the agricultural states.

The per cents of net additions to profits, to capital and to surplus of the national banks in California compared to United States banks and Oregon banks are as follows:

| *Year* | *California per cent* | *U. S. per cent* | *Oregon per cent* |
|---|---|---|---|
| 1921 | 13 | 9.40 | 7.46 |
| 1922 | 15.01 | 7.79 | 2.20 |
| 1923 | 13.45 | 8.48 | 1.93 |
| 1924 | 11.64 | 8.11 | 5.02 |
| 1925 | 10.80 | 9 | 6.09 |
| 1926 | 11.54 | 9.54 | 6.25 |
| 1927 | 10.58 | 9.24 | 5.10 |
| 1928 | 7.06 | 8.96 | 6.97 |

The national bank system in California shows greater addition to profits than for the United States as a whole and considerable greater addition than its neighboring state. We have not attempted to compare it with the larger number of states in the agricultural region that have shown capital and surplus losses rather than additions during that period.

From the standpoint of number of banks to population, adequate banking services exist without the overbanked situation which exists in most other states. In 1919, 2.11 banks were operating for each

10,000 population and in 1929, 1.02 banks per 10,000 population. This latter figure compares with 1.98 for the United States as a whole.

In sum, we find that the development of branch banking in California has provided adequate banking services, has prevented the overbanked condition existing in many other parts of the United States, has provided adequate profits for the banking system, is still heavily drawing upon the national banks to be succeeded by state charters and, finally, it shows no cessation in competition of banks for the development of the agricultural and industrial progress of the state.

## CHAPTER XI

### The Revolution in Banking Theory

THREE trends that have been developing in the banking field are now arresting public attention.

1. The failure during the past eight years of 4,925 banks out of a total of 30,812 in operation on June 30, 1921, has called into question the soundness of the system. From the public standpoint the essential feature of a banking system is that the bank acts as a safe repository of the funds entrusted to it; that within limits these funds may be used by the bank for investments; but that eventually the funds must be returned to the depositors. This fundamental of a sound banking system is being called into question by the appalling fact that within eight years almost one-sixth of the United States banks have been suspended with losses to the depositors.

2. In spite of the prohibition of branch banking by national statute and by laws in most states, over 6,000 banks in the United States are in no sense independent unit banks, but are grouped in chains by holding companies, corporations, partnerships or individuals. In other words, the theory of the independent local unit bank has broken down in 25 per cent of the banks in the United States. The

restriction of branch banking is bringing into existence chains of banks, some of them threatening to become systems, controlled outside either the state or federal system and varying in financial resources from powerful, well-managed groups of influential city and central banks under publicly incorporated and capitalized holding companies to groups of banks precariously owned by individuals and susceptible of questionable management.

3. Finally, there is the movement toward bank mergers, presaging a new financial era. In the last eight years, the number of banks has been reduced by almost 5,000. In part this reduction is due to bank failures, and in part to the absorption of banks by mergers. Though the number declined, the total resources of all banks, and of the average bank, increased, indicating the trend to larger banking units. A recent series of mergers brought the resources of a new New York bank to 2½ billion dollars, a veritable financial empire and symptomatic of the merging movement.

Summarizing the three movements: we are faced with a banking weakness, as shown by the large number of failures; there is a tendency toward unification of the banking system by chain and group banking, thus circumventing the restrictions on branch banking; and the same tendency is working by means of mergers. These movements are related, and primarily have their inception in the integration that is taking place in business and industry and is creating a new economic era.

The theory of the national government, and of most states, on which the United States banking

system is established is that each bank should be a local institution, locally financed and managed, drawing funds from local depositors and using its financial resources for the development of local business enterprises. Such lapses as have occurred in the history of the national banking development and those that have taken place in some states only serve to emphasize the tenacious adherence, in both legislative and banking circles, to the theory of the unit bank. Efforts to establish a national banking system have in the past been hampered by the fear that such banks will become dominant factors and will centralize the banking field.

The years of the Civil War, and the reconstruction period afterward, emphasized the need of a national fiscal agency, and at that time a national banking system was established; but, in conformity with the principle of the unit bank, no banking head was given the system until 1913, when, after a long period of acrimonious debate, in which the sacredness of the local bank was the dominant issue, the Federal Reserve System was established. The new system, through its centralized agency, permitted certain cooperation, notably for reserves and discounts, with its member banks, but forbade branch banking,—that is ownership of one bank by another,—thus maintaining the integrity of the unit bank system.

A majority of the states have followed the lead of the federal government and have prohibited branch banking to the state chartered banks, though in several instances this statement needs qualification. Some states, like New York, permit branch banking

within city limits, on the theory that branches established for the convenience of scattered customers within the city do not impeach the principle of the unit bank. Practice in other states varies. California, for example, permits branch banking to its state chartered banks, limited only by state boundaries.

This liberality on the part of some states toward branch banking began to affect the Reserve System. It became increasingly onerous in New York City for national banks to compete with state banks for deposits when the state banks had branches scattered in convenient neighborhoods, whereas the business of the national banks was confined to one headquarter, usually in the financial district. In other large cities, members of the Federal Reserve System were placed under similar disadvantages. In consequence, bank after bank changed from national to state charter, and members of the Reserve System dropped out in increasing numbers in order to take advantage of the more liberal provisions of the state charters.

In 1919, the state banks' resources comprised 55.41 per cent of the total and in March, 1929, they were 60.15 per cent. The resources of the national banks had declined from 44.59 per cent in 1919 to 39.85 per cent in 1929. In order to enable the national banks to compete with the state banks, Congress passed the McFadden Act, permitting the establishment of branch banks to members of the Federal Reserve System in states where branch banks are permitted by state law, but in any event limiting such branch banks strictly to city limits.

The situation, then, that the banking community is facing today is that historically, legally and in theory the unit bank is still intrenched in the national banking system and in that of most of the states. Branch banking is permitted under national charters only within city limits, and under most state laws there is the same restricted limit. Because of legal adherence to this theory, there are now in the United States 25,961 supposedly local self-contained banks representing a decline from the peak of 30,812 banks in 1921.

It should be noted, in passing, that neither in Canada nor in Europe has banking developed along any such theory. Thus, Canada has eleven banks with 4,040 branches; the United Kingdom has seventeen banks operating through thousands of branches in England, Ireland, Scotland and Wales; some of them being represented in the West Indies, Palestine, Egypt, India and practically every part of Africa under the British flag, and even in parts of foreign Africa; banking in France, Germany, Denmark, Holland and other commercial European countries is similarly centralized.

During the past ten years a business revolution has taken place. Whereas formerly each town had independent grocery, clothing, drug and other retail stores, an ice plant, a local trolley system, an electric light plant, a power house, coal yards and thriving local industries, today the whole aspect of the town has changed. The independent retail stores have given way to chain stores; electricity, gas, water and transportation are now supplied by public utility corporations that are state-wide or regional

in character. Local industries have been merged with larger corporations. The financing of these enterprises, once a profitable outlet for investment of the funds of the local banks, is now being done by central banking institutions, equipped to render adequate service to the larger business units.

The banks of the country have lagged behind industry in aligning themselves with the new order. The local store is only a distributing office of a vast national system of chain stores. It is in charge of a manager who receives the produce and sees that it is sold, but one who does not buy or secure credit, and who is not in any way active in the financing of the company. To be sure, he deposits his daily receipts in the local bank, but the transfer from the local bank to the central institution is of such short duration that this checking account, in common with a large number of other small checking accounts, is a loss to the bank rather than an asset. Certainly the bank has lost the opportunity it had with the independent merchant to deal with his substantial checking account, to take care of a part of his money in a savings account, and to finance him with loans. Instead of dealing with a local, independent business man, the bank is now dealing with a transient, promotion-seeking manager. The same holds true of the local gas office, now a branch of a regional utility corporation; or the local electric light office, or scores of other local business institutions. Tires, drugs, automobiles, groceries, clothing, hardware, dry goods, shoes, candy, tobacco, household furniture, kitchen equipment, electrical equipment, radios, refrigerators, heaters and scores

of other commodities are today sold through chain stores and distribution is directed from offices in central cities.

There remains for the country bank the business of the remaining local enterprises and also that vast portion of banking business lying outside the immediate civic limits of the town comprising the tributary agricultural interests. But agriculture for the past decade has been the most consistently depressed industry in the United States and bankers who were compelled to find their business in agriculture now find themselves loaded with frozen assets and with a great deal of worthless bank paper. In fact much of the banking distress is a direct consequence of farm distress. Moreover, even here the banker gets the skim milk of the business. The better farm mortgages are handled through the Federal Farm Banks and the more desirable self-liquidating commodity loans are endorsed by cooperatives and made through their finance organizations, either with larger metropolitan banks or with the Intermediate Credit Banks.

The change in merchandising has had its effect on banks in the metropolitan cities, which have been forced to expand their capitalization in order to supply credit to these new clients whose annual business runs into the hundreds of millions of dollars. The legal loaning capacity to any one client is 10 per cent of the bank's capital and surplus. When there were developed such businesses as Woolworth's, with $287,000,000 sales annually, Sears, Roebuck & Company with $347,000,000 sales, the Goodyear Tire Company with $233,000,000 sales,

and hundreds of other organizations with annual sales running well into nine figures, even the largest bank in America, with its capital and surplus of $75,000,000 in 1927, was able to lend only $7,500,000 to any one of these clients. This seems like a good-sized loan, but it is wholly inadequate when we deal with an expanding industry running its sales up to three and four hundred million dollars annually. In consequence, there was the need for expansion of the loaning capacity of banks by increased capitalization and by mergers. During the past five years, in the ten largest cities in the United States, fifty-two mergers have taken place, creating three banks with over one billion dollars deposits; twelve with over five hundred million; and one hundred eight with over fifty million. The extent to which industry has driven banks toward concentration of their resources is shown by the fact that seven banks, comprising 0.1 per cent of the total number in these ten cities, have 18.7 per cent of the total invested capital and 20.3 per cent of the total banking resources.

But while this evolution toward industrial concentration has opened new avenues for banking business in the large cities, which increasingly form the centers from which industrial enterprises of the country emanate, the banks in the smaller towns have not prospered. The failure of about 5,000 banks in the last eight years has already been noted, but the significance to the whole banking system emerges sharply when it is noted that 88.6 per cent of these banks were the smaller banks, with a capitalization of $100,000 or less, and that 87.7 per cent of the failures occurred in communities of 5,000

population or less. These figures clearly isolate bank suspensions to the small bank and in the small town, the town from which individual enterprise has departed.

It seems idle to labor the point, confirmed by a wealth of evidence, that the smaller banks in the smaller town do not pay; that the many failures among them, and the precarious return on capital invested in them, are making for a lack of depositor and investment confidence; that, in fact, it is the small bank in the small town that is today the most formidable threat to the banking system. An increase of 7,000 per cent in Postal Savings deposits in one Northwestern state gives an isolated idea of the extent to which depositors are losing confidence in the small banks.

The situation has developed within it the seeds for its own remedy. As already pointed out, the centralizing tendency of industry has been proscribed for banks. The bank may not become the local office of a stronger central banking institution, by the prohibition of branch banking. However, facing the facts of an increasingly centripetal tendency in industry, a vanishing town and agricultural banking business, and a transfer of the banking from small local banks to well-capitalized, growing, central institutions, the banking system has been forced, law or no law, to adjust its business to these changing economic conditions. In theory, the creation of a locally managed and financed banking unit may be ideal; in practice it has got out of step with the march of progress.

As a substitution for branch banking, there has

developed the chain bank or group bank; that is, a group of banks owned by a holding company, a group of individuals, or by one person—not a bank, as in branch banking. Bank stock is property and can be conveyed legally; hence, when a bank stockholder is approached by a holding company to sell or exchange his stock, there is no legal way of checking such transactions as may result in the concentration of several banks under the ownership of individuals, groups or corporations. Such chain banking differs from branch banking in that the local board of directors is retained; that the bank is nominally run independently; but that savings in overhead, possible in branch banking, may be more difficult, or out of the question. In law and in theory these banks are independent. In practice, of course, the board of directors becomes virtually the creature, if not the employee, of the holding company, and the bank is controlled as thoroughly as a branch bank, though somewhat more cumbersomely.

Moreover, there are some dangers in the situation. The chain of banks may include, and in fact frequently does include, state banks distributed over several states and national banks. The holding company itself is not subject to examination by either federal or state banking commissioners. The banks themselves come under varying examination systems—some by one state, some by another, and a third group by the federal bank examiner. It becomes relatively easy to shift doubtful paper from one bank to another, until it will finally secure lodgment in the bank with the most lenient supervision. It is made increasingly easy, moreover, to shift the

bank's assets, to use the funds for non-banking purposes, or to centralize them for the development of some business of major interest to the holding company. Growth of chain banking is so rapid that figures given at any time are soon out of date. At this writing some 240 groups, owning about 1,800 banks, are known, and if to these are added the city branch banks and branch banks existing under some state laws, there are today some 6,000 banks that are not independent units in accordance with the theory of the law.

In practice, then, about one-fourth of the banks in the United States have drifted away from the theory of the unit bank. It must be recognized that the chain bank has sprung up in accordance with an economic need, that in an age of centralizing industry it is an essential substitution for branch banking. Many chain banks, under corporate control, have all the virtues inherent in sound banking business; they supplement and welcome thorough examination; they are desirous to promote and develop sound local banking practices; they supply the local management with excellent economic services, and they are able to supplement the local management by skillful shifting of deposits and credits, and by opening avenues for investments. Along these lines, many holding companies are developing sound and profitable banking business, yet there is also the opportunity for the individual, holding controlling stock in several banks, to take advantage of the weakness of the system outlined above.

A change in the United States banking system seems imminent. It is not improbable that, if the

prejudices against branch banking continue to dominate legislation, a system of banking under a few large holding companies will develop, which will be to all intents and purposes outside either the state or the federal banking system, which will supply the economic need of branch banking, and which will have none of its public safeguards. In spite of the liberalizing McFadden Act, permitting restricted branch banking, there have been continued defections in the Reserve System since the passage of that Act. Since February, 1927, over 300 national banks, scattered among 41 states, with assets of nearly 3 billion dollars, have been superseded by state banks. The McFadden Act, therefore, has not checked the withdrawals from the Reserve System. To be sure, it would be unwise to advocate any catchpenny legislation merely to strengthen the national banking system. But when that system is out of step with the economic trend of the country; when it imposes a banking scheme inadequate to handle modern business; when it compels by legal evasions reorganization of the banking scheme into groups that threaten to create a bootleg banking system—then the theory needs revision in the light of modern needs.

Opposition comes from the local bankers, many of them successful even under present progressively disadvantageous conditions, bankers who refuse to immolate themselves on the altars of progress. It is significant, however, that at the American Bankers' Association meeting at San Francisco in October, 1929, the Comptroller of the Currency, Mr. J. W. Pole, courageously disregarded the position taken

by some of his predecessors, and, with some rather sound reservations, advocated a change in the federal law in regard to branch banking. The account from the convention indicates that Mr. Pole's views coincide with those of the Treasury Department, and possibly of the Administration. It is, therefore, to be presumed that proposed legislation along this line will find its way into Congress during the 1930 session. If so, it will be a most significant step to change the financial and banking aspect of America. It will undoubtedly result eventually in the passing of the unique and distinctly American institution, the unit bank, and in the substituting for it of branches of powerful central institutions. Sentimentally one must regret the passing of the unit bank, entwined as it is with the history and development of a once-virgin continent and conceived by a people loving individuality and financial independence in community affairs. The course, however, seems inevitable, and delay will retard and distort normal banking development, but cannot check the substitution of regionally widespread banking systems for the unit bank.

# INDEX


A

Agriculture, after Civil War, 109 *et seq.*
as political factor, 99
consistently depressed, 195
critical condition, 95 *et seq.*
difficulty with, 109
during World War, 98, 111
effect on banking, 95
exports, 107, 111
financing, 115
inadequate banking facilities, 158
in California, 173, 177 *et seq.*
in relation to efficiency, 103 *et seq.*
instruments of revolution, 100 *et seq.*
law of supply and demand, 120
marketing associations, 105
necessary reduction, 100
need of contact with world, 108
overexpansion, 115 *et seq.*
post-war, 98, 111 *et seq.*
prior to the war, 97 *et seq.*
result of revolution, 101 *et seq.*
solution in migration, 102
*Amalgamation of English Banking*, Syke, 138, *note*
American Bankers' Association, 53, 57
American Bankers' Convention, 94
American Express Co., 21
American Retailers Association, 9
American Stores, 6
American Telephone & Telegraph Co., 6
*Annalist, The,* x; 146, *note*
Associated Merchandising Corp., 9
*Atlantic Monthly,* x

B

Banker, agricultural field, 9 *et seq.*
exit of country, x, 85
local handicap, 10 *et seq.*
Banking, adequate facilities, 158
after the Civil War, 66 *et seq.*
archaic, 43
behind industrial needs, 82
bootleg system, 200
branch (*see* separate item)
centralization of resources, 89
chain (*see* separate item)
change imminent, 1 *et seq.*, 199 *et seq.*
comparison of English and American, 133
conglomerate structure, 42
connection with speculation, 128
criticism of Canadian, 166 *et seq.*
decentralized system, 126
deterioration in small town, 11
English Big Five, 135
failure of national, 70 *et seq.*
federal legislation, 88

Banking—(*Continued*)
formidable threat to, 197
good year, 37
group (*see* separate item)
hand-maiden to industry, 66
improved measures, 139 *et seq.*
inadequacy of, 13 *et seq.*
in earlier days, 66 *et seq.*
national system, 58 *et seq.*
plethora of service, 47
reasons for strong national system, 65
recent development, 11 *et seq.*
relation of speculation to, 120 *et seq.*
remedial measures, 197
revolution in theory, 15, 189 *et seq.*
state system, 58 *et seq.*
summary of situation, 48 *et seq.*
theory of United States, 30
unchanged in fundamentals, 11
uniform commercial, 65 *et seq.*
weaknesses of system, 41 *et seq.*
Bank of America, 20
Bank of America of California, growth, 182
organization, 169 *et seq.*
Bank of East Aurora, 72
Bank of England, effect of amalgamation, 141 *et seq.*
first branch bank, 132
hub of system, 142
Bank of Italy National Trust & Savings Corp., growth stifled, 182
largest branch bank in United States, 185
national institution, 180
organization, 169 *et seq.*
Bank of La Salle, 72
Bank of Manhattan, 21
Bank of Snyder, 72
Banks, adherence to unit, 191
burden of country, 11
capital and resources, 19
causes of suspension, 42
chart of profit and loss, 36
checking of loans, 129
competition, 48
confidence impaired, 32
critical position of country, 27 *et seq.*
decline in national, 63
effect of mergers, 18
English capital table, 139
English mergers, 25
exit of unit, 85, 201
Federal Loan, 10
frozen assets, 127
function, 29 *et seq.*
in agricultural regions, 94, 108
Intermediate Credit, 11
loans, 122 *et seq.*, 196
metropolitan mergers, 13 *et seq.*
national resources, 62 *et seq.*
reason for failures, 32
reasons for mergers, 20 *et seq.*
resource charts, 60 *et seq.*
restriction of note issue, 148
shift from national to state, 185 *et seq.*, 192
state resources, 59 *et seq.*
subject to examination, 198
suspension charts, 28
suspension of small, 27 *et seq.*, 41
suspension tables, 30 *et seq.*, 34 *et seq.*
table by population, 44 *et seq.*
table correlating branches to suspension, 83
table of assets, 69
table of earnings, 38 *et seq.*
table of growth, 16
table of succession, 64
Barclay's Bank, 135

Branch banking, absorption of units, 136
area, 169
arguments pro and con, 80 *et seq.*
a tested system, 145
basic principles for establishing, 182 *et seq.*
beyond city limits, 25
Canadian sanction, 156
compared with chain, 52
conflict with chain, 90
connecting link, 129 *et seq.*
connection with modern business, 179 *et seq.*
criticism of, 163
defined, 50, 76
diminution of inflated market, 128 *et seq.*
diversified Canadian system, 161
easier mobilization, 143
effect of legislation, 92
effect on services, 140 *et seq.*
evils, 86 *et seq.*
geographic limitations, 80
in California, 169 *et seq.*
in Canada, 146 *et seq.*
in relation to agriculture, 94 *et seq.*
in spite of prohibition, 189
international connections, 114
in the United Kingdom, 132 *et seq.*
legal restrictions, 134
limited growth, 144
methods in use, 133
organization in California, 174 *et seq.*
place in federal system, 79
prohibition, 64
rapid shifting of funds, 160
reasons for, 75 *et seq.*
relation of speculation, 120 *et seq.*
relation to business, 117 *et seq.*
Branch banking—(*Continued*)
relation to profits, 143 *et seq.*
relation to unit personnel, 174
resistance to, 49
salutary influence, 142
source of opposition to, 200 *et seq.*
stabilizing factor, 129 *et seq.*, 141
state legislation, 78 *et seq.*
substitution for, 197 *et seq.*
table of operation, 77
to ease economic changes, 181
type of consolidation, 86
under the McFadden Bill, 65
within a state, 59
Business, cyclical activity, 117 *et seq.*
need of balanced activity, 119
reason for overproduction, 123 *et seq.*
revolution, 193 *et seq.*
stabilizing use of credit, 131
wholesale prices, 118

C

California, branch banking in, 169 *et seq.*
chart of branch banking system, 170
cooperative marketing associations, 180 *et seq.*
varying types of agriculture, 177
Canada, bankers' relation to public, 164
banking system, 82
bank insolvencies, 151 *et seq.*
branch banking system, 114
clearing cities, 158 *et seq.*
elasticity of currency, 159
excerpts from Year Book, 147 *et seq.*
internal bank organization, 167 *et seq.*

Canada—(*Continued*)
lack of central bank policy, 165
prosperity, 146 *et seq.*
table correlating capital to liabilities, 165
table of bank absorptions, 154
table of branch banks, 157
table of insolvencies, 152, 155
Canadian Bankers' Association, 149
Chain banking, contrasted with branch, 52
development, 50 *et seq.*
extent of survey, 71 *et seq.*
manipulation, 55
model in operation, ix
rapid growth, 199
resources, 57
size of system, 74
substitute for branch, 198
system, 51 *et seq.*
types, 53 *et seq.*
weaknesses, 56 *et seq.*
Chase National Bank, 17, 21
Cheney, on industrial revolution in England, 102
Committee on Recent Economic Changes, 3
Consolidation, Canadian bank, 151, 162
checked in England, 135 *et seq.*
data showing trend, 2 *et seq.*
economic consequences, 138 *et seq.*
effect on independent business, 1 *et seq.*
examples of, 6 *et seq.*
in banking, 12
indicative of second industrial revolution, 1
in independent stores, 7 *et seq.*
movement toward bank, 190
of California banks, 169 *et seq.*
Consolidation—(*Continued*)
of English banking, 132 *et seq.*
reason for bank, 20 *et seq.*
relation to competition, 145
vast United-Schulte, 6
Cortlandt Trust Co., 72
Country Life Commission, 98
Cox, James M., on agriculture, 113

D

Dawes, Henry M., against branch banking, 75 *et seq.*, 89
"Deterioration of the American Bank Portfolio," E. C. Harwood, 126, *note*
Drygoods Union of the Syndicate Trading Co., 9

E

*Electrical World*, on merger in public utilities, 4
England, Big Five, 23
examples of amalgamation, 137 *et seq.*
increased safety of banks, 142 *et seq.*
less speculative mania, 130
ratio of banks to population, 47
result of amalgamations, 136 *et seq.*
Europe, branch banking system, 114
centralized banking in, 193
financial centralization, 22 *et seq.*

F

Failures, analysis of commercial, 2
Farmers Bank, 161

Farmers' Loan & Trust Co., 20
Federal Farm Loan Banks, 33
Federal Farm Loan Board, 32
Federal Reserve Bank of New York, discount rates, 125
Federal Reserve Board, 125
on bank failures, 42
work of, 67
Federal Reserve System, 58, 78, 126
at present, 70
established, 191
facilitates elastic currency, 159
inaugurated, 67
in danger, 58 *et seq.*, 91
instrument of cooperation, 88
membership, 67 *et seq.*
object of, 90
result of 1907 panic, 127, 131
First Trust Co., 72
France, banking amalgamation, 23
less speculative mania, 130

G

General Motors Corp., 13
Germany, Big Four, 23
less speculative mania, 130
Giannini, A. P., on branch banking, 20, 172 *et seq.*
Goodyear Tire Co., 195
Great Atlantic & Pacific Tea Co., 7
Group banking, contrasted with chain, 55 *et seq.*
defined, 55
weaknesses, 56 *et seq.*
Guaranty Trust Co., 17

H

Hahn Department Stores, 6
Hansen, Henry, Canadian editor of *The Annalist*, x; 146, *note*
Harris, Callie, old-type banker, 94 *et seq.*
*Harvey Baum—A Study of the Agricultural Revolution*, Mead and Ostrolenk, 97, *note*
Hoover, Herbert, conception of the farmer, 110
creation of Farm Board, 97
on agriculture, 99

I

Independent Grocers Alliance, 8
Intermediate Credit Banks, 195
International Acceptance Bank, 15, 21
Interstate Commerce Commission, 4
Irving Trust Co. of New York, 21

J

Japan, banking amalgamation, 23
Joint Stock Land Banks, 33

K

Kresge Stores, 6

L

Lackawanna National Bank, 72
Legislation, antitrust, 22
British North America Act, 147
Canadian bank, 147 *et seq.*
English banking, 132
farm, 96 *et seq.*
first Canadian bank, 147 *et seq.*
Fordney Emergency Tariff, 96
liberalizing, 200
McFadden bank, 21, 63, 75, 81, 170 *et seq.*, 185, 186, 192

Legislation—(*Continued*)
McNary-Haugen, 96 *et seq.*
National Bank, 58
on branch banking, 191 *et seq.*
on the establishment of branch banks, 78 *et seq.*
proposed, 201
theory behind, 70
Liggett Stores, 7
Lloyds Bank, 23, 135
Lodge, Henry Cabot, on agriculture, 113

M

McCrory's Stores, 7
McKesson & Robbins, Inc., 9
Manhattan Co., 15
Manufacturers' National Bank of Troy, 72
Manufacturers' Trust Co. of New York, 21
Marine Midland Corp., 71
Marine Trust Co. of Buffalo, 71
Marine Trust Co. of the City of New York, 71
Market, ignored by industrial leaders, 119
irregularity of, 121
panic of 1929, 125
public institution, 124
Midland Bank, 23, 135
Montgomery Ward & Co., 7
Mount, A. J., president of Bank of Italy, 182

N

Nassau National Bank of Brooklyn, 20
National City Bank, 15 *et seq.*, 20, 21
National Provincial Bank, 135
National Retail Owned Wholesale Grocers Association, 9
National Tea Co., 7
New York Stock Exchange, 121
Niagara Co. National Bank & Trust Co., 72
Niagara Falls Trust Co., 72

O

Orleans County Trust Co., 72
Ostrolenk, Esther W., x

P

Panic, of 1929, 119 *et seq.*
Penney, J. C., 6
Peoples Trust Co., 72
Pole, John W., Comptroller of the Currency, x, 201
on branch banking, 80 *et seq.*, 138, 166
on weakness of group banking, 56 *et seq.*

R

Recent Economic Changes, 2, *note*
Rexall Drug Co., 7
Royal Bank, 161

S

Schulte Cigar Stores, 6
Sears, Roebuck & Co., 7, 13, 195
State Trust Co., 72
*Statist, The*, 144, *note;* 153 *et seq.*, 162
Stocks (*see* Market)

T

Transamerica Corp., extent of control, 171 *et seq.*
organizations controlled by, 172
Treasury Committee on Bank Amalgamations, inaugurated in England, 135
report, 23 *et seq.*

"Troubled Waters of Distribution," Marvin K. Black, 7, *note*

U

Union Bank, 161
Union Trust Co., 72
Union Trust Co. of Rochester, 72
United Cigar Stores, 6
United Drug Co., 6
United States, agriculture, 10
bank failures, 153
branch bank extension, 133
centralized banking facilities, 130
chartering of second bank, 66
democratic theory, 86 *et seq.*
early trust movements, 23
elimination of unit banker, 136
United States—(*Continued*)
extent of bank suspensions, 187, 189
first bank chartered, 66
improvement in banking, 48
inadequate facilities for agriculture, 158
ratio of banks to population, 187 *et seq.*
stock markets, 121
unification in industry, 22
United States Rubber Co., 14
United States Steel Corp., 6, 14

W

Warburg, Paul M., 15
Westminster Bank, 135
Woolworth Co., 13, 195
Workers Trust Co., 72

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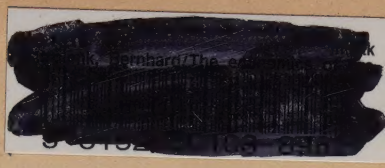

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